STATE OF NEW JERSEY
Board of Public Utilities
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TELECOMMUNICATIONS

IN THE MATTER OF THE BOARD'S REVIEW OF UNBUNDLED NETWORK ELEMENTS RATES, TERMS AND CONDITIONS OF BELL ATLANTIC-NEW JERSEY, INC.	)))))	DECISION AND ORDER ON MOTIONS FOR RECONSIDERATION AND REQUEST FOR LIMITED REOPENING AND MOTIONS TO STRIKE

DOCKET NO. TO00060356

(SERVICE LIST ATTACHED)

BY THE BOARD:

This Decision and Order memorializes the decision rendered by the Board of Public Utilities ("Board") at its public agenda meeting of September 13, 2004 regarding the cost of capital, depreciation and vertical feature cost inputs used in calculating the rates for unbundled network elements ("UNEs") that Verizon New Jersey Inc. ("Verizon," "VNJ" or "Company"), formerly known as Bell Atlantic New Jersey, provides to competitive local exchange carriers ("CLECs"). This Decision and Order are issued in response to motions for reconsideration, filed by Verizon and AT&T Communications of NJ, L.P. ("AT&T") of the Board's Decision and Order issued on May 7, 2004 in this docket. Submissions in support of and in opposition to these motions were also filed by MCImetro Access Transmission Services, L.L.C. ("MCI") and the Division of the Ratepayer Advocate ("RPA"). The Board has reviewed in detail the submissions of Verizon, AT&T, MCI and the RPA and concludes that no grounds exist for reconsidering its May 7, 2004 UNE Order. Accordingly, the Board denies Verizon's and AT&T's Motions for Reconsideration, for the reasons stated below. This Decision and Order includes the Board's findings and determinations in support thereof.

BACKGROUND AND PROCEDURAL HISTORY

In its *Generic Order* issued on December 2, 1997,[1] the Board set initial rates, terms, and conditions for access to UNEs consistent with the Total Element Long Run Incremental Cost ("TELRIC") methodology articulated by the Federal Communications Commission ("FCC") in its Local Competition Order.[2] AT&T Communications of NJ, L.P. ("AT&T") and MCI challenged the Board's decision in the United States District Court for the District of New Jersey ("District Court").[3] On June 6, 2000, the District Court issued a decision that affirmed in part, reversed in part, and remanded in part issues addressed in the *Generic Order.*[4]

After careful consideration, the Board completed its review on remand on November 20, 2001, and issued its *Final Order* on March 6, 2002, wherein it adopted modified inputs and assumptions used in the cost models to calculate recurring and non-recurring rates, and established the terms and conditions under which certain advanced services would be made available to CLECs.[5]

The *Final Order* reduced many of the wholesale rates that VNJ had been charging CLECs pursuant to the *Generic Order*. Following the release of the Board's Final Order, MCI, AT&T and the Division of the Ratepayer Advocate filed motions for reconsideration alleging that the Board had erred in rendering its decision and did not fully follow the FCC's TELRIC requirements and applicable law. After a review of the reconsideration requests, the Board rendered its decision on reconsideration at its July 15, 2002 agenda meeting, which was set forth by the Board in its *Order on Reconsideration* dated September 13, 2002.[6]

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[1] See Decision and Order, In the Matter of the Investigation Regarding Local Exchange Competition For Telecommunications Services , Docket No. TX95120631 (Dec. 2, 1997) ("Generic Order").

[2] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers , CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 15616-775 (1996) ("Local Competition Order"), aff'd in part and vacated in part sub nom . Competitive Telecommunications Ass'n v. FCC, 117 F.3d 1068 (8th Cir. 1997) and Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), aff'd in part and remanded, AT&T v. Iowa Utils. Bd., 525 U.S. 366 (1999), on remand, Iowa Utils. Bd. v. FCC, 219 F.3d 744 (8th Cir. 2000), reversed in part sub nom. Verizon Communications Inc. v. FCC, 535 U.S. 467 (2002); Order on Reconsideration, 11 FCC Rcd 13042 (1996); Second Order on Reconsideration, 11 FCC Rcd 19738 (1996); Third Order on Reconsideration and Further Notice of Proposed Rulemaking, 12 FCC Rcd 12460 (1997), further reconsideration pending.

[3] See AT&T Communications of New Jersey, Inc., et al. v. Bell Atlantic-New Jersey, Inc., et al., Civ. Nos. 97-5762 (KSH) and 98-0109.

[4] See AT&T Communications of New Jersey, Inc., et al. v. Bell Atlantic-New Jersey, Inc., et al., Civ. Nos. 97-5762 and 98-0109 (KSH) (D.N.J. June 6, 2000).

[5] See Decision and Order, I/M/O the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc., Docket No. TO00060356 (March 6, 2002)("Final Order") (executed on behalf of the Board by Commissioners Frederick F. Butler, Carol J. Murphy and Connie O. Hughes).

[6] See Decision and Order, I/M/O the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc., Docket No. TO00060356 (September 13, 2002). ("Order on Reconsideration") at 9-12 (summarizing generally the parties' arguments for reconsideration).

Subsequent to the release of the Board's *Order on Reconsideration*, on November 7, 2002, VNJ filed a Complaint[7] in District Court pursuant to 47 U.S.C. §252(e)(6) of the Telecommunications Act of 1996.[8] The Complaint filed against both the Board and individual Commissioners in their official capacities (collectively referred to herein as the ("Board"), consisted of three counts. Count One alleged that the UNE rates established by the Board failed to comply with the FCC's TELRIC methodology, as set out in the 1996 Act and its implementing regulations. Count Two alleged that the Board's UNE rates are below VNJ's actual costs and constitute an unconstitutional taking under the Fifth and Fourteenth Amendments to the United States Constitution. Count Three alleged that the Board's action further constituted a violation of VNJ's civil rights under 42 U.S.C. §1983. In its Complaint, VNJ requested that the case be remanded to the Board for further review of the inputs and assumptions used to develop the UNE rates for compliance with the FCC's TELRIC methodology. The Board filed an Answer to VNJ's Complaint on December 23, 2002.[9]

Subsequently, on November 26, 2003, VNJ filed a Motion for Leave to File and Serve an Amended Complaint expanding its Complaint to include three additional counts. Proposed Counts Four and Five alleged that the UNE rates established by the Board violate the Fifth and Fourteenth Amendments on additional grounds. Proposed Count Six alleged that the UNE rates adopted by the Board in the Order on Reconsideration are inconsistent with the Board's findings and are arbitrary, capricious, and unreasonable. MCI, AT&T and the Board filed responses to the proposal by VNJ to amend its Complaint.

During the pendency of the litigation involving VNJ and the Board in the District Court, on August 21, 2003, the FCC released its Triennial Review Order,[10] providing new, additional guidance to states that may affect the UNE rates established by the states in following the FCC's TELRIC methodology. The FCC provided clarification on two key inputs used by states to set TELRIC-compliant rates: depreciation and cost of capital.

On December 19, 2003, VNJ and the Board entered into a Stipulation and Agreement whereby VNJ and the Board agreed to seek leave of the District Court to dismiss VNJ's Complaint, without prejudice, in exchange for an expedited review by the Board of the above-mentioned inputs that were used to calculate the current rates associated with UNEs that VNJ is required to provide to CLECs.

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[7] Verizon New Jersey Inc. v. New Jersey Board of Public Utilities, et al., Civil Action No. 02-5353 (JAP). MCI filed a Counterclaim and a Cross-claim on December 20, 2002. VNJ and the Board filed Answers to MCI's Counterclaim and Cross-claim. By Orders dated March 21, 2003, the Court granted AT&T leave to intervene and RPA leave to participate as *amicus curiae*.

[8] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified in various sections of 47 U.S.C. § 151 et seq. (the "1996 Act").

[9] On February 25, 2003, the Board filed a Motion to Dismiss Counts Two and Three. Supporting and responsive briefs were also filed with regard to that Motion to Dismiss Counts Two and Three.

[10] Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers , Federal Communications Commission, CC Docket Nos. 01-338, 96-98,98-147, Report and Order and Order on Remand, Further Notice of Proposed Rulemaking, (rel. Aug. 21, 2003) ("Triennial Review Order" or "TRO").

In accordance with the terms of the Stipulation and Agreement, and following a December 17, 2003 agenda meeting announcing its decision, the Board issued an Order on December 23, 2003, directing the reopening of the "UNE proceeding to review the cost of capital and depreciation inputs that were relied upon by the Board in setting the current UNE rates."[11] The Board's *Review Order* also established a procedural schedule in accordance with the terms of the Stipulation and Agreement and designated Commissioner Connie O. Hughes as the Presiding Commissioner in this matter.[12] On December 29, 2003, pursuant to Federal Rules of Civil Procedure 41(a)(2), VNJ filed with the Honorable Joel A. Pisano, U.S.D.J., a proposed form of Order of Dismissal, dismissing without prejudice VNJ's Complaint in accordance with the terms of the Stipulation and Agreement entered into between VNJ and the Board, dismissing the Board's pending motion to dismiss Counts Two and Three of the Complaint, dismissing VNJ's pending motion for leave to file an Amended Complaint without prejudice, and ordering that the District Court shall retain jurisdiction to enforce all provisions and obligations set forth in the Stipulation and Agreement. On January 14, 2004, Judge Pisano entered an Order approving the terms of, and retaining jurisdiction to enforce, the Stipulation and Agreement.[13]

On December 29, 2003, AT&T filed a petition for reconsideration, reversal or modification of the Review Order,[14] and on December 30, 2003, MCI filed a motion for a stay of the Board's decision to reopen the proceeding as set forth in the Review Order.[15] MCI requested that the Board hold all further proceedings in this docket in abeyance, and further sought a determination by the Board that when it reopens the UNE case, the proceeding will "include an examination of the cost model, all current inputs and other data needed to develop a current TELRIC rate, in accordance with applicable FCC requirements."[16] The Board conducted a thorough review of the arguments articulated by AT&T and MCI, and by Order dated January 26, 2004, the Board denied AT&T's

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[11] See Order, I/M/O the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc., Docket No. TO00060356 (December 23, 2003) ("Review Order") at 3.

[12] Review Order at 4. On January 9, 2004, Commissioner Connie O. Hughes issued a provisional Order reflecting a revised procedural schedule which modified the dates by which parties were to file discovery and testimony. Order, I/M/O the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey Inc., Docket No. TO00060356 (January 9, 2004).

[13] See January 14, 2004 Order issued by Judge Pisano in Verizon New Jersey Inc. v. the New Jersey Board of Public Utilities, et al., Civil Action No. 02-5353 (JAP). On April 1, 2004, Judge Pisano executed a Revised Order Dismissing Plaintiff Verizon New Jersey Inc.'s Claims Without Prejudice. The Revised Order confirmed that the January 14, 2004 Order was not intended to be a final appealable order.

[14] See AT&T's December 29, 2003 Emergency Petition filed with the Board, for Reconsideration of Order Reopening Proceeding in Docket Number TO00060356 ("AT&T's Motion for Reconsideration").

[15] December 30, 2003 Letter Motion of MCI filed with the Board, to hold in abeyance all further proceedings in Docket Number TO00060356 ("MCI's Motion for a Stay") at 1.

[16] MCI's Motion for Stay at 1.

Motion for Reconsideration and MCI's Motion for a Stay in their entireties,[17] and continued forward with the reopened UNE proceeding.[18]

Active parties in the reopened UNE proceeding included the following: VNJ, RPA, AT&T, and MCI. All parties except MCI filed testimony and supporting documentation and cost models.[19] Evidentiary hearings were conducted before Commissioner Connie O. Hughes from February 17, 2004 through February 20, 2004. Following the close of evidentiary hearings, the parties filed their initial briefs on March 1, 2004 and filed their reply briefs on March 8, 2004.[20]

Following review of the testimony and evidence provided, on May 7, 2004, the Board issued its Decision and Order ("2004 UNE Order").[21] With respect to the two revised UNE inputs, the Board: 1) revised its finding on the appropriate weighted cost of capital to be used in calculating UNE rates to 9.88%, which consists of a cost of debt of 6.26%, a 12% cost of equity, and a debt/equity ratio of 37% debt and 63% equity; 2) affirmed its previous finding on depreciation lives, which established economic depreciation lives utilizing the mid-point of the FCC regulatory ranges; 3) rejected both VNJ's and AT&T's proposals to weight the vertical features cost for which there are no algorithms and found that the SCIS cost model must be modified by applying Staff's recommended alternative weighting methodology; 4) modified the switching cost study submitted by VNJ due to an incorrect switch mix in the Port and Usage studies to ensure consistency with the other switching modules utilized in developing switching costs; and 5) ordered

[17] See Order Denying Motions, I/M/O the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc., Docket No. TO00060356 (January 26, 2004) ("1/26/04 Order").

[18] The Board also continued forward with its separate TRO proceeding, I/M/O the Implementation of the Federal Communications Commission's Triennial Review Order, Docket No. TO03090705. However, subsequent to the decision issued by the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") in United States Telecom Association v. Federal Communications Commission, 359 F.3d 554 (D.C. Cir. 2004) ("USTA II") (decided March 2, 2004), which vacated certain portions of the TRO, including the FCC's subdelegation to state commissions of decision-making authority over impairment determinations, VNJ filed a Motion for a Stay of the Board's TRO proceeding, except for the hot cuts related portion of the proceeding. By Order dated March 17, 2004, in I/M/O the Implementation of the Federal Communications Commission's Triennial Review Order, Docket No. TO03090705, the Board granted VNJ's Motion for a Stay conditioned upon VNJ's agreement to forebear seeking relief from the FCC on the basis that the Board did not timely complete its TRO obligations as specifically outlined in the Board's March 17, 2004 Order.

[19] VNJ submitted its pre-filed Initial testimony on January 6, 2004 and provided the cost models and supporting worksheets on January 8, 2004. Rebuttal testimony was filed on January 23, 2004 and VNJ's Surrebuttal testimony was filed on February 6, 2004. VNJ presented pre-filed testimony of the following witnesses: Dr. James H. Vander Weide on the cost of capital issues, Marsha S. Prosini on the issue of the Telcordia Switching Cost Information System ("SCIS") Cost Model sponsored by VNJ, David Garfield on the SCIS Cost Model and Dr. John M. Lacey on depreciation. AT&T presented pre-filed testimony of John I. Hirshleifer on the cost of capital issues, Michael R. Baranowski on the SCIS Cost Model and Richard B. Lee on depreciation. The RPA presented pre-filed testimony of James Rothschild on the cost of capital issues and Susan M. Baldwin on depreciation. MCI did not file or introduce testimony of any witness in this proceeding.

[20] Specifically, the following parties filed initial briefs: VNJ, the RPA, AT&T, MCI, Conversent Communications of New Jersey, LLC jointly with Covad Communications Company ("Conversent and Covad" or "CCNJ-CCC") and the Communication Workers of America ("CWA"). VNJ, the RPA, AT&T and MCI filed reply briefs.

[21] In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Decision and Order, Docket No. TO00060356 (May 7, 2004) ("2004 UNE Order").

the following loop and switching rates based upon the approved inputs and modifications:

2-Wire Loop
Density Cell 1 $8.81
Density Cell 2 $10.42
Density Cell 3 $11.82
Statewide Average $10.32

Switching

Port Charge	$2.72
Originating Usage	$.001399
Terminating Usage	$.001364

With respect to Staff's alternative weighting methodology and modifications to the SCIS cost model adopted by the Board in its 2004 UNE Order, the Board directed Staff to provide its spreadsheets used in developing its alternative methodology to actively participating parties to the proceeding. The Board further directed that any comments relating to the alternative methodology be submitted to the Board and participating parties.[22] Comments were received from Verizon and AT&T on May 14, 2004.[23]

On May 24, 2004, VNJ filed a Motion for Reconsideration and Request for Limited Reopening of the UNE Proceeding, requesting that the Board, *inter alia*: 1) revise its approved cost of capital and depreciation inputs; 2) modify its findings to establish vertical feature costs using the Telcordia SCIS Cost Model proposed by VNJ, and 3) reopen the proceeding to re-evaluate the Board's decision to base the UNE rates on the use of Integrated Digital Loop Carrier ("IDLC") technology.[24]

Also on May 24, 2004, AT&T filed a Petition for Reconsideration seeking Board reduction of the cost of capital and cost of debt.[25] AT&T also sought to defer implementation of any increase in Verizon's UNE prices until the parties had been afforded the opportunity to submit evidence on all material changes in costs since the close of the previous record.

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[22] *Id.* at 37-39.

[23] Comments of AT&T Communications of NJ, L.P. on Staff's Alternative Methodology for Switch Vertical Feature Costs, In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 (May 14, 2004)("AT&T Comments"); Letter dated May 14, 2004 to Kristi Izzo, Secretary of the Board, from Hesser G. McBride, Jr., In the Matter of the Board's Review of Unbundled Network Elements Rtes, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 ("Verizon Comments").

[24] Motion for Reconsideration and Request for a Limited Reopening of the Board's Unbundled Network Element Rte Setting Proceeding, In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 (May 24, 2004) ("VNJ Motion").

[25] Petition of AT&T Communications of NJ, L.P. for Reconsideration, In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 (May 24, 2004) (AT&T Motion").

The Ratepayer Advocate and MCI submitted letter briefs in response to Verizon's motion and AT&T's petition on June 9, 2004.[26] On the same day AT&T filed a document styled as a "reply" in opposition to Verizon's Motion, and Verizon filed a brief in opposition to AT&T's Petition.[27] On June 18, 2004, both AT&T and VNJ filed briefs in reply to the opposition briefs filed by each party on June 9, 2004.[28]

In response to these June 18 replies, the RPA filed a written objection with the Board,[29] stating that Verizon's and AT&T's June 18 reply submissions were improper under the BPU's rules, and that said replies should be struck from the record.[30] Both AT&T and VNJ filed oppositions to the RPA's Motion to Strike, dated July 8 and July 7, 2004 respectively,[31] to which the RPA responded by letter to the Board dated July 14, 2004.[32]

[26] Letter dated June 9, 2004 to Kristi Izzo, Secretary, Board of Public Utilities, from James H. Laskey, In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 ("MCI Opposition"); Letter dated June 9, 2004 to Kristi Izzo, Secretary, New Jersey Board of Public Utilities from Christopher J. White, Esq., In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 ("RPA Opposition").

[27] Reply of AT&T Communications of NJ, L.P. to Verizon New Jersey Inc. Motion for Reconsideration and Request for Reopening, In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 (June 9, 2004) ("AT&T Opposition"); Brief of Verizon New Jersey Inc. In Opposition to the Petition for Reconsideration of AT&T Communications of NJ, L.P., In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356, (June 9, 2004) ("VNJ Opposition")

[28] Reply Brief of Verizon New Jersey Inc. to the Briefs in Opposition to the Motion for Reconsideration of Verizon, New Jersey Inc., In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 (June 18, 2004) ("VNJ Reply"); Reply of AT&T Communications of NJ, L.P. to Oppositions to Petition for Reconsideration, In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 (June 18, 2004) ("AT&T Reply").

[29] Letter dated June 24, 2004 to Kristi Izzo, Board Secretary, from Maria T. Novas-Ruiz, Esq., In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356.

[30] The Board acknowledges that its rules do no explicitly permit reply briefs in connection with this type of proceeding. However, the Board believes that under the circumstances of this proceeding the fullest possible record informs the Board's analysis and final decision, and furthers the public interest. Moreover, all parties have been afforded adequate opportunity to respond to all evidence presented in the record, including the reply briefs and accompanying certifications submitted by AT&T and VNJ. Given this opportunity, no party has demonstrated that it has been unfairly prejudiced by the inclusion of all relevant evidence in the record. For these reasons, the Board exercises its administrative discretion under N.J.A.C. 14:1-1.2(a) to permit the filing of reply briefs by the moving parties, and also permits the certifications of Eugene Goldrick and Matthew G. Mercurio, offered by VNJ and AT&T respectively, to be entered into the record of this proceeding.

[31] Reply of Verizon New Jersey to Request of Division of Ratepayer Advocate to Strike Reply to Oppositions to Petitions for Reconsideration In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 (July 7, 2004); Reply of AT&T Communications of NJ, L.P. to Request of Division of Ratepayer Advocate to Strike Reply to Oppositions to Petitions for Reconsideration, In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 (July 8, 2004).

AT&T also filed a Motion to Strike sections of VNJ's June 18, 2004 reply brief, accompanied by the Certification of Matthew D. Mercurio.[33] AT&T argued that pages 28 through 30 of VNJ's reply brief and the accompanying Certification of Eugene Goldrick, dealing with Staff's proposed methodology to calculate certain vertical feature costs, were not responsive to arguments made by the other parties and were therefore improper, and were in fact new defenses in support of Staff's vertical feature methodology.[34] In the alternative, AT&T argued that the certification of Dr. Mercurio should be admitted into the record.[35] VNJ replied by letter dated July 21, 2004, in which it opined that the portions of its brief sought to be struck by AT&T are directly responsive to positions advocated by AT&T and MCI in their briefs filed in response to VNJ's Motion for Reconsideration.[36] VNJ stated[37] that it had no objection to the admission of Dr. Mercurio's Certification in the event that the Board denied AT&T's Motion to Strike.

STANDARD OF REVIEW

As an initial matter, the Board notes that, with regard to this or any other proceeding, it has authority to "order a rehearing and extend, revoke or modify an order made by it." N.J.S.A. 48:2-40. This authority is part of the Legislature's "comprehensive legislative design...of continuous supervision, with a mandate to the Board to resolve initial investigations, expeditiously, and yet granting to it concomitant authority to institute corrective proceedings and especially where experience furnishes evidence of failure of an earlier order to accomplish its intended purpose." New Jersey Bell Telephone Company . Department of Public Utilities, Board of Public Utility Commissioners, 12 N.J. 247, 254-255 (1951). In New Jersey Bell, the Court stated that:

> [w]here the petition for rehearing seeks to reopen the matter for the purpose of introducing evidence of changed circumstances, the Board's action in allowing or denying the rehearing is discretionary and may be set aside only for abuse of the delegated legal discretion.
> [New Jersey Bell, supra, 12 N.J. at 582.]

Moreover, when the petition for rehearing appears merely to reiterate the facts and arguments contained in the petitioners' briefs already considered by the Board, and contains "no clear indication of the nature of the "material errors" the [petitioners] alleged

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[32] Letter dated July 14, 2004 to Kristi Izzo, Secretary of the Board of Public Utilities from Christopher J. White Esq., In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356.

[33] Motion of AT&T Communications of NJ, L.P. to Strike Portions of Verizon's June 18 Reply Submission or, In the Alternative, to Allow AT&T to File Supplemental Response, In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356 (July 8, 2004).

[34] *Id.* at 4.

[35] *Id.* at 5-6.

[36] Letter dated July 21, 2004 to Kristi Izzo, Secretary of the Board from Hesser G. McBride, Jr., In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., Docket No. TO00060356.

[37] *Id.* at 2.

were in the Board's decision...the Board's denial of the petition [is] within their discretion." *Id.* at 581-582. Absent a showing of a new development, new evidence relating to already established facts, or a material misapprehension by the Board concerning an essential matter which is critical to its final determination, the Board will not reconsider its final decision. See Order Denying Motion for Reconsideration, Re: Public Service Electric and Gas Company, 1999 W.L. 33178824, *6 (N.J.B.P.U.), BPU Docket Nos. EO97070461, EO97070463 (October 19, 1999), citing In re Trantino Parole Application, 89 N.J. 347, 365 (1982); Trap Rock Industries, Inc. v. Sagner, 133 N.J. Super. 99, 110 (App. Div. 1975)

DEPRECIATION LIVES

In its Motion, VNJ generally argues that the Board's decision in its 2004 UNE Order to retain the mid-point of the FCC's depreciation lives previously adopted by the Board is contrary to the both the TRO's clarification and the *Virginia Arbitration Order* upon which the Board relied.[38] In support of its position, the Company raises several arguments which it believes provide the basis for reconsideration. The Company also believes that the lives are contrary to the interests of both New Jersey and consumers.[39] More specifically, the Company believes that the Board's decision must be reconsidered based upon the following contentions:

1) The Board's May 7, 2004 Order "fundamental misapprehends TELRIC's mandate that depreciation lives must reflect a market in which full competition among facilities-based carriers already exist."[40]

2) The Board's adoption of the mid-point of the FCC lives is inconsistent with the *Virginia Arbitration Order* relied upon by the Board."[41]

3) The Board's Order "fails to address the undisputed principle that companies operating in fully competitive markets establish depreciation lives in accordance with GAAP."[42]

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[38] VNJ Motion at 24, *citing* I/M/O Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc. and for Expedited Arbitration, Petition of AT&T Communications of Virginia, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., CC Docket Nos. 00-218, 00-251, Memorandum Opinion and Order, (August 28, 2003) ("Virginia Arbitration Order").

[39] *Id.* at 28.

[40] *Id.* at 29.

[41] *Id.* at 31.

[42] *Id.* at 33.

4) The Board's retention of FCC lives is contrary to the interests of consumers, competition, and telecommunications network investment in New Jersey; the mid-point of the FCC lives protects only the hefty profit margins of CLECs."[43]

Each of Verizon's arguments in favor of the Board's reconsideration of its findings regarding depreciation will be addressed individually below.

1. TELRIC-Mandated Assumptions Regarding State of Competition

Positions of the Parties

In its Motion, the Company argues that the FCC clarified that TELRIC's mandate requires that the depreciation inputs of UNE rates "should reflect any factors that would cause a decline in asset values, such as competition and advances in technology."[44] Specifically, the Company cites language in the TRO stating that in "calculating depreciation expense, therefore, the rate of depreciation over the useful life should reflect the actual decline in value that would be anticipated in the competitive market TELRIC assumes."[45]

In further support of its position, VNJ argues that the TRO explicitly mandates that the various components of TELRIC – including depreciation lives and cost of capital -- must be developed using a consistent set of assumptions about competition. The Company cites paragraph 680 of the TRO which states:

> The objective of TELRIC is to establish a price that replicates the price that would exist in a market in which there is *facilities-based competition*. In this type of competitive market, all facilities-based carriers would face the risk of losing customers to other facilities-based carriers, and that risk should be reflected in TELRIC prices.[46]

Based on the foregoing, VNJ concludes that under TELRIC, depreciation lives must reflect forward-looking markets in which VNJ faces the real risk of losing customers to facilities-based competitors.[47]

However, according to the Company, the Board ignored the TRO's clarification and justified its retention of the midpoint of the FCC Lives by "imposing on Verizon NJ an

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[43] *Id.* at 37.

[44] *Id.* at 29.

[45] *Id.* at 29, citing TRO at ¶689.

[46] *Id.* at 29, citing TRO at ¶690.

[47] *Id.* at 29, citing TRO ¶¶680, 685, 689.

evidentiary burden that directly conflicts with TELRIC's mandate."[48] Specifically, the Company avers that the Board rejected Verizon's Generally Accepted Accounting Principles ("GAAP") lives because "the Company was unable to identify any technological developments that would hasten the retirement of its assets or require it to accelerate its investment in new facilities in order to compete more efficiently against CLECs..." [49]

Similarly, the Company argues that the Board erred by relying on the *Virginia Arbitration Order* and penalizing VNJ for not providing "specific quantifiable evidence to support its position" or producing "any documents or evidence that it in fact had actual business plans to retire any assets in response to competitive developments."[50] In the Company's opinion, this is "plain, reversible error, by imposing a burden of coming forward not a part of the law."[51] According to VNJ, the TRO does not require Verizon NJ to demonstrate increased competition to obtain forward-looking depreciation lives that would be used by a company operating in a fully competitive environment.[52] VNJ reiterates these arguments in its reply to the opposition briefs submitted by all other parties.[53]

AT&T, MCI and the RPA all submitted opposition briefs to VNJ Motion for Reconsideration. In its opposition brief AT&T asserts that VNJ's arguments have no merit, and that VNJ failed to meet its burden in arguing for shorter lives.[54] AT&T points out that VNJ's "real grievance" is that the Board decided not to revert to the asset lives originally adopted in the Board's 1997 Generic Order.[55] In support of is position, AT&T explains that the Board's decision in 1997 stemmed from an arrangement between the Board and VNJ's predecessor, Bell Atlantic-New Jersey, to accelerate the deployment of broadband-capable fiber cable and facilities in New Jersey.[56] AT&T further argues that to base depreciation lives on the accelerated retirement of copper cable and other narrowband assets under Opportunity New Jersey would violate a key element of the FCC's Local Competition Order: cost causation.[57]

AT&T also points out that the competitive risk assumption prescribed by the FCC was not meant to relieve VNJ of the burden of justifying the use of shorter asset lives.[58]

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[48] *Id.* at 29.

[49] *Id.* at 29-30

[50] *Id.* at 30

[51] *Id.*

[52] *Id.*

[53] VNJ Reply at 20-22.

[54] AT&T Opposition at 7.

[55] *Id.*

[56] *Id.*

[57] *Id.*

[58] *Id.* at 9.

According to AT&T, even the FCC refused to mandate the use of financial lives because the Incumbent Local Exchange Carriers ("ILECs") had not provided any empirical basis on which the FCC could conclude that financial lives will be more consistent with TELRIC that regulatory lives. Rather, according to AT&T, the FCC left it to the states' discretion to select appropriate asset lives.[59]

The RPA asserts that VNJ provided no substantive or credible evidence, aside from hearsay, that its proposed GAAP lives are TELRIC-compliant.[60] Even accepting VNJ's argument, the RPA opines that the Company failed to demonstrate that GAAP lives are the only appropriate depreciation lives.[61] The RPA also points out that VNJ did not contest that the depreciation lives adopted by the Board in its March 6, 2002 UNE Order and in fact represented to the FCC that said rates were TELRIC-compliant in connection with the New Jersey 271 proceeding, as a result of which VNJ received authorization from the FCC to provide long distance telephone service in New Jersey.[62]

MCI also agrees that the FCC has not mandated the use of GAAP depreciation lives.[63] MCI opines that given the lack of evidence in the record suggesting any change in the rate of plant retirements, it was clearly reasonable for the Board to adhere to its prior use of FCC regulatory lives.[64]

Board Discussion

Verizon presents no new evidence or argument in support of its position regarding the appropriateness of GAAP lives in calculating its UNE rates. Moreover, its reiterated argument fundamentally misconstrues VNJ's own burden in this proceeding as well as the Board's findings in its 2004 UNE Order.

In its 2004 UNE Order the Board correctly noted that VNJ had failed to identify any technological developments that would hasten the retirement of assets or require it to accelerate its investment in new facilities in order to compete in the competitive UNE environment envisioned in the TRO.[65] Such a burden is not inconsistent with the assumptions set forth by the FCC in the TRO. Indeed, without such data it would be, and was, impossible for the Board to determine what the actual decline in value in VNJ assets will be on a going-forward competitive basis. The Board was further unable to discern how each of the proposed lives were developed and if they could reasonably be attributed to competitive developments in the marketplace that would cause an increased decline in asset values over the life of the asset.

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[59] *Id.*

[60] RPA Opposition at 9-10.

[61] *Id.* at 9.

[62] *Id.*

[63] MCI Opposition at 2.

[64] *Id.*

[65] 2004 UNE Order at 28.

In its 2004 UNE Order the Board implicitly rejected the testimony of Verizon witness Lacy regarding the suitability of GAAP lives for the purposes of setting TELRIC-compliant UNE rates.[66] The Board does so again explicitly herein, by finding such testimony to be lacking in probative value, given Mr. Lacy's relative inexperience with depreciation issues and lack of knowledge concerning VNJ's existing network.[67] Similarly, the Board reasonably gave no weight to the forecast provided by Technology Futures, Inc. ("TFI") on behalf of Verizon. The Board found TFI's forecasts, predicting "waves" of plant replacements, to be so speculative in nature as to contain little probative value.[68] The Board notes, for example, evidence in the record indicating that TFI previously failed to predict the advent of DSL technology, allowing the extension of service lives for copper cable in Verizon's network.[69] No argument made by VNJ at this stage of the proceeding warrants the Board's reconsideration of this conclusion.

The Board agrees that the Company has no obligation to demonstrate the existence of a competitive UNE market, now or in the future. However, VNJ must still demonstrate how the existence of such a competitive market actually changes the value of assets and their depreciable lives. This Verizon failed to do to a sufficient degree. In the absence of such proofs, and in light of the availability of unbiased lives developed by the FCC for regulatory purposes, the Board reasonably deemed the latter more appropriate in a UNE rate context. Nothing presented by VNJ on reconsideration is grounds for changing this determination.

2. Board's Adoption of the Mid-Point of FCC Asset Lives

Positions of the Parties

In retaining the FCC Lives, VNJ also argues that the Board erred by relying upon the *Virginia Arbitration Order*.[70] Specifically, the Company avers that the Board's Order referenced the *Virginia Arbitration Order* when concluding that:

> (1) Verizon NJ failed to provide specific quantifiable evidence that increased competition and technological change warrant adoption of GAAP lives; and
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> (2) Verizon NJ's consideration of ILECs, CLECs, cable television providers and TFI depreciation rates as benchmarks to its GAAP rates is inappropriate.[71]

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[66] *Id.*

[67] AT&T IB at 10-13.

[68] 2004 UNE Order at 29, citing *Virginia Arbitration Order* at ¶115.

[69] AT&T IB at 14

[70] VNJ Motion at 31.

In support of its contention, VNJ asserted that Board Staff, when recommending the retention of depreciation rates based on the mid-point of the FCC Lives, erroneously stated that its recommendation was similar to decisions that were made in several other jurisdictions, including the Virginia Arbitration.[72]

In addition, the Company criticizes the Board's Order for not acknowledging that the *Virginia Arbitration Order* adopted the low end of the FCC Lives while both the FCC and Board's rationale were similar.[73] According to the Company, the Board's failure to acknowledge the substantial difference between the mid-points of the FCC Lives it retained and the shorter low-end of the FCC Lives adopted in the *Virginia Arbitration Order* constitutes a material error, which resulted in UNE rates that are inconsistent with the competitive and technological assumptions required under TELRIC.[74]

In response to briefs filed by other parties in opposition to its motion, Verizon asserts that AT&T incorrectly argued that the *Virginia Arbitration Order* applied the low end of the FCC's regulatory lives only to certain assets.[75] VNJ asserts that the FCC in fact applied the low end of the asset lives to all assets at issue in that proceeding.[76]

In AT&T's opinion, both the TRO and the *Virginia Arbitration Order* require VNJ to demonstrate, through empirical data, that technological advances and increased competition justify the use of shorter lives.[77] However, AT&T does not believe that VNJ has met its burden. AT&T questions the empirical data that VNJ purports to present, arguing that the recent trends in assets lives actually experience by VNJ require longer, not shorter lives.[78]

With regard to VNJ's argument that the Board did not even consider the low end of the FCC's range, AT&T points out that nowhere in its testimony or briefs did VNJ propose the adoption of such lives and in arguing that the Board should now do so, omitted vital data in quoting the FCC's position.[79] Specifically, AT&T asserts that VNJ failed to preserve this issue for administrative review, and the Board should therefore not consider it on reconsideration.[80]

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[71] *Id.*

[72] *Id.*, citing Transcript of 4/2/04 Board Agenda Meeting, p.9.

[73] *Id.*at 31.

[74] *Id.* at 32.

[75] VNJ Reply at 23-24.

[76] *Id.* at 23.

[77] *See* AT&T Opposition at 12-13.

[78] AT&T Opposition at 13.

[79] *Id.* at 12-13.

[80] *Id.* at 12

Moreover, according to AT&T, the *Virginia Arbitration Order* does not require that the state commissions adopt the low end of the FCC-approved lives.[81] In that decision, AT&T points out, the FCC's Wireline Bureau found that "The safe harbor lives [prescribed by the FCC] represent the [FCC's] most recent assessment of the forward-looking asset lives of each of the accounts."[82] Moreover, AT&T avers that the Wireline Bureau determined only that in "certain cases," were the mid-points of the asset lives proposed in that proceeding by AT&T and WorldCom too long to be consistent with forward-looking principles.[83] Specifically, according to AT&T, the Wireline Bureau only cited the 17-year life used for digital switching equipment proposed by the CLECs, which the Bureau rejected in light of the FCC's determination in 1999 – five years after its originally prescribed depreciation lives – that ILECs could use a life as short as 12 years for such equipment under the safe harbor, rather than the previously-prescribed low end of 16 years.[84] Therefore, AT&T concludes that the *Virginia Arbitration Order* requires use of the low end of the "safe harbor" only upon a showing that the mid-point would be too long to be consistent with forward-looking principles.[85] AT&T claims that VNJ has not described any particular FCC-approved asset lives which meet that criterion.

The RPA argues that VNJ's assertion that the Board's adoption of the mid-point of the FCC lives is inconsistent with the *Virginia Arbitration Order* is misplaced, because the Virginia Order imposes no such requirement.[86] The RPA argues that under said Order the FCC's Wireline Bureau required Verizon to make a showing that technological advances and increased competition require shorter asset lives, which it failed to do.[87] VNJ has, according to the RPA, similarly failed to make such a showing in the instant proceeding.[88]

The RPA also argues that Verizon is precluded by waiver and estoppel from asserting that the mid-point of the FCC regulatory lives is not TELRIC-compliant, base upon its positions taken in the New Jersey 271 proceeding.[89] According to the RPA, VNJ essentially represented to the FCC that the UNE rates in effect at that time, which incorporated the mid-point of the FCC asset lives, were TELRIC-compliant. Moreover, the rates were reviewed by the FCC, which agreed with Verizon that the rates fell within

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[81] *Id.*

[82] *Id.* at 12-13, citing *Virginia Arbitration Order* ¶ 112.

[83] *Id.* at 13

[84] *Id. See also* VNJ IB at 52 n.160 (describing FCC's 1999 determination regarding low end of range for digital switching equipment).

[85] *Id.*

[86] RPA Opposition at 10.

[87] *Id.*

[88] *Id.*

[89] *Id.* at 9, fn.19.

the TELRIC range.[90] Thus, according to the RPA, VNJ is now precluded from taking an opposite position than that taken in the 271 proceeding.[91]

Board Discussion

In focusing to such a degree on the *Virginia Arbitration Order*, Verizon misconstrues the Board's 2004 UNE Order. In that Order, the Board adopted the mid-range of the FCC regulatory lives because the evidentiary record supported such a determination. Specifically, the Board implicitly accepted evidence put forth by AT&T demonstrating that such lives were based on updated assessments of company plans, retirement patterns, and current technological developments and trends.[92] The Board also notes the aggregate rise in VNJ's depreciation reserves, indicating that the depreciation lives currently in effect are appropriate.[93]

As stated above, the Board also rejected VNJ's request to alter the regulatory lives in place since 2002 because no evidence had been presented suggesting that those lives were not forward-looking, reliable estimates of the economic lives of assets in a competitive environment. In fact, ample evidence of the opposite was presented.[94] Verizon failed to demonstrate convincingly in the record, with credible, quantifiable evidence, that shorter GAAP lives were justified by expected technological retirements in a competitive environment. It also failed to show why SEC-derived financial reporting lives, used for an entirely different purpose than regulatory lives used to derive TELRIC-compliant UNE rates, should be mandated at this time.

It is thus irrelevant that the FCC chose the lower end of the FCC regulatory lives in its *Virginia Arbitration Order*. The Board's decision is not based exclusively, or even substantially, on the FCC Wireline Bureau's actions in Virginia. The Virginia Order was cited merely for the proposition that a substantial evidentiary showing is required to justify the use of GAAP reporting lives, and that the FCC's regulatory lives are forward-looking.[95] Based on the record before it, the Board determined that the mid-range of the FCC regulatory lives was appropriate in New Jersey. VNJ presents no new evidence in its Motion that requires reconsideration of this finding.

Even if the Board had "relied" on the *Virginia Arbitration Order* to the extent alleged by Verizon, it would have done so in a manner consistent with the actual content of that order. In fact, the FCC made clear in both the TRO and in the Virginia Order that the mid-range of its regulatory asset lives could be appropriate for the purpose determining depreciation expense barring credible evidence specifically demonstrating that specific

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[90] *Id.*

[91] *Id.*

[92] 2004 UNE Order at 25, 28-29.

[93] *Id.* at 25.

[94] *Id.*; AT&T IB at 7.

[95] 2004 UNE Order at 29.

asset lives were too long, pursuant to TELRIC principles.[96] As discussed above, VNJ presented no such evidence, beyond its general assertion that GAAP financial lives are more appropriate predictors of asset depreciation in a going-forward competitive environment than regulatory lives. The Board has already considered and rejected this argument. Moreover, the FCC's application of the low end of its asset life range to all plant assets at issue in the Virginia proceeding does not, as VNJ appears to now argue, relieve it of the burden of showing the specific need for shorter lives in New Jersey. Thus, Verizon's assertion that the Board's use of the mid-range of the FCC's regulatory lives constitutes a "glaring fundamental error" in violation of FCC guidance in the *Virginia Arbitration Order* is simply incorrect.[97]

3. GAAP Lives v. FCC Regulatory Lives

Positions of the Parties

VNJ also contends that the Board's May 7th UNE Order failed to account for the fact that fully competitive markets require the use of GAAP depreciation lives.[98] Verizon argues that it has demonstrated that GAAP lives are the depreciation lives utilized by companies that operate in fully competitive markets and are therefore the lives that best reflect the competitive and technological assumptions associated with such a market.[99] It bases its conclusion on its belief that GAAP lives are developed using up-to-date information to take into account the anticipated impact of future technologies and actual and anticipated competition.[100] VNJ further maintains that its lives are reviewed on an annual basis by both the Company and the outside auditors to ensure that they reflect the most recent information available.[101]

In support of its recommendation, the Company argues that is expert witness has worked with Verizon's depreciation personnel for several years, reviewed the methods used by Verizon NJ to formulate its GAAP lives and concluded that the Company applied the correct factors by considering future competition and technological change, as well as capital spending, budget and engineering plans in evaluating whether its calculated depreciation lives were reasonable and in conformance with GAAP.[102]

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[96] See TRO at ¶68, *Virginia Arbitration Order* at 112-113.

[97] The Board agrees with the RPA that the doctrines of waiver and judicial estoppel are applicable in an administrative context. See State v. Gonzalez, 142 N.J. 618, 632 (1995). However, given our decisions on the issues herein, we find it unnecessary at this juncture to determine whether VNJ is precluded from presenting arguments as to the TELRIC compliance of depreciation lives or the Board's Integrated Digital Loop Carrier ("IDLC") assumptions. By so ruling, the Board does not waive, and expressly reserves, its right to assert the applicability of these doctrines to any position taken by VNJ or any other party herein in any future or related proceeding.

[98] VNJ Motion at 33.

[99] *Id.*

[100] *Id.*

[101] *Id.*

[102] *Id.* at 33-34.

In addition, Verizon believes that it has presented substantial evidence demonstrating that in a competitive telecommunications markets, such as the one TELRIC requires, companies generally establish economic depreciation lives in accordance with GAAP.[103] In further support of its contention, VNJ points to the current trend of shorter depreciation lives in the telecommunications industry which, in the opinion of VNJ, was also acknowledged by AT&T in a financial and operational overview presented on February 25, 2004.[104] The Company further maintains that its lives are reviewed on an annual basis by both the Company and the outside auditors to ensure that they reflect the most recent information.[105]

The Company believes that the Board ignored the substantial evidence provided by Verizon NJ that GAAP-based depreciation lives are appropriate for companies operating in fully competitive markets. The Company also criticizes the Board's discounting of the fact that VNJ's GAAP lives have been accepted by the Securities and Exchange Commission ("SEC") by concluding that "the SEC has statutory duties the differ from the requirement imposed by the 1996 Act and were not designed to protect ratepayers, but designed to protect investor interests."[106] According to the Company, the SEC requires companies to file financial statements that are materially accurate and conform with GAAP. Therefore, VNJ alleges that its lives are compliant with SEC regulations.[107] VNJ also argues that its benchmarking of asset lives to those of other ILECs, CLECs and cable television companies was entirely appropriate.[108]

AT&T contests VNJ's position that competitive markets require the establishment of depreciation rates based upon GAAP. According to AT&T, in competitive markets, economic depreciation lives are not determined by accounts or accounting principles, but by markets.[109] In addition, AT&T points out that GAAP lives, while properly benchmarked, reviewed by auditors and approved by the SEC, are still financial lives used for a purpose other than setting TELRIC rates.[110] AT&T also asserted that GAAP lives produce a conservative bias that would artificially inflate costs and possibly impede competition.[111]

The RPA argues that VNJ has failed to present any new arguments not already considered by the Board and believes that the lives should be longer, not shorter.[112] The RPA also argued that FCC-prescribed lives are forward-looking.[113]

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[103] *Id.* at 34.

[104] *Id.*

[105] *Id.* at 33.

[106] *Id.* at 34-35.

[107] *Id.* at 35

[108] *Id.* at 36.

[109] AT&T Opposition at 14

[110] AT&T Opposition at 16.

[111] *Id.* at 15.

Board Discussion

The Board is aware that many companies use GAAP lives for financial reporting purposes. The Board also acknowledges that TELRIC-compliant depreciation lives must be developed based on the assumption that VNJ operates in a market in which there is full competition among facilities-based carriers. However, VNJ has not addressed the overarching issue herein: whether GAAP lives are *more* appropriate as an element of TELRIC-compliant UNE rates supplied on a wholesale basis to CLECs than the FCC's regulatory lives. In its 2004 UNE Order the Board concluded, based on the record, that GAAP lives were biased in a manner designed to protect the interests of investors.[114] This ensures that the Company is able to recover the depreciable expense associated with an asset as soon as possible before it is replaced or becomes obsolete. However, such a recovery may not correspond with the actual useful life of the asset for the purpose of setting UNE rates. Nor would such a focus, which may result in faster depreciation and greater cost from an accounting perspective, protect ratepayers whose rates are based on the cost of providing service.[115] No evidence provided by Verizon effectively rebutted this distinction.

For the reasons stated above, the Board also agreed with AT&T and other parties that the testimony of Verizon witness Lacy and the TFI study offered in support thereof were not due substantial probative weight.[116]

We note that the application of the TELRIC methodology does not necessarily result in only one appropriate set of asset lives. Rather, TELRIC is capable of producing a range of appropriate outputs for rate setting purposes.[117] With this in mind, we have found that the evidentiary record fails to demonstrate, at the very least, that GAAP lives are more TELRIC-compliant than the FCC's regulatory lives. At the same time, ample evidence exists in the record demonstrating that the FCC's regulatory lives are forward looking and account for ongoing changes in technology and retirement patterns. Thus, Verizon has failed to demonstrate any grounds for reconsideration of the Board's retention of FCC regulatory depreciation lives.

It should also be noted that VNJ's blanket assertion that GAAP lives are always superior to FCC regulatory lives ignores such evidence and ignores the FCC's refusal to take such an absolute position. Rather, the FCC has acknowledged that regulatory lives may

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[112] RPA Opposition at 10.

[113] RPA Opposition at 13.

[114] 2004 UNE Order at 28-29.

[115] See AT&T IB at 15-20; RPA IB at 7-9.

[116] AT&T IB at 11-13; RPA IB at 10-12.

[117] See RPA Opposition at 7. We reject AT&T's assertion, made in the cost of capital context, that such an acknowledgement improperly imposes the standard of review utilized by the FCC in its Section 271 proceedings (See AT&T Reply at 11-14). AT&T argues in essence that the FCC's lack of adequate time and resources to devote to its Section 271 determinations necessitated its application of a relaxed or "TELRIC-light" standard which is not applicable herein. We find this theory to be lacking in legal or evidentiary support.

be more appropriate in the UNE rate context by permitting the states to determine, on an individual basis, whether GAAP or regulatory lives should be applied in their own markets.[118]

Finally, we reject VNJ's renewed argument that its proposed GAAP lives are accurate as benchmarked against the asset lives used by a wide range of telecommunications companies, including other ILECs, CLECs and cable television companies. The record demonstrates that the actual assets used by such a diverse group of entities is too dissimilar to be of use as an appropriate benchmark for UNE depreciation lives.[119] It is apparent, for example, that an interexchange carrier ("IXC") uses different types of switches and cables than either an ILEC or a stand-alone UNE provider would.[120] Moreover, cable television company assets are used in part to provide video services that have no relevance to the voice services at issue in this proceeding. Thus, VNJ has failed to demonstrate that the Board's rejection of GAAP-compliant asset depreciation lives constitute a material mistake or misapplication of the law.

4. Advancement of Interests Of Consumers, Competition, And Telecommunications Network Investment In New Jersey

Positions of the Parties

According to the Company, the FCC lives fail to achieve the Board's stated goal of protecting consumers or competition.[121] In support of its position, VNJ avers that the use of the longer FCC lives discourages both CLEC and Verizon NJ investment in New Jersey because CLECs have no incentive to invest when they can purchase UNEs at below cost rates that result from what it describes as excessive FCC Lives for UNE rate setting.[122] Similarly, the Company argues that it has no incentive to make additional investment because the long FCC lives prohibit Verizon NJ from realizing a reasonable return on its investment.[123] VNJ also argues that the current asset lives proposed by AT&T would merely serve to perpetuate the high profit margins enjoyed by the CLECs.[124]

AT&T alleges that such considerations are irrelevant to the issue of TELRIC compliance, and should therefore not be considered by the Board.[125] AT&T also disagrees with

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[118] *See, e.g.* TRO at ¶688

[119] AT&T IB at 20-21.

[120] *Id.* at 21.

[121] VNJ Motion at 37.

[122] *Id.*

[123] *Id.*

[124] *Id.*

[125] AT&T Opposition at 46-48.

VNJ's assertion that UNE rates set lower than those proposed by VNJ would have negative economic consequences for New Jersey.[126] AT&T further disputes VNJ's assertion that current rates produce windfall profits for AT&T through the service of local customers via UNEs, since VNJ's analysis purporting to illustrate this point fails to take into consideration actual costs of service incurred by AT&T.[127]

In reply to AT&T's opposition, VNJ asserts that the economic consequences of excessively low UNE rates are a highly relevant issue for consideration by the Board. It reiterates its argument that AT&T enjoys large profit margins through its service of UNE customers.

Board Discussion

The Board's analysis of VNJ's arguments leads it to conclude that such arguments merely reiterate positions previously taken by VNJ and rejected by the Board. The Board therefore declines to reiterate in depth its previous responses thereto. In short, Verizon offers no new evidence or argument demonstrating that GAAP lives should be substituted for the FCC regulatory lives in place since 2002, based on the need to protect the interests of New Jersey consumers. The Board disagrees with Verizon's claim that the increase in UNE rates caused by the adoption of shorter GAAP lives would not affect the rates CLECs charge to consumers. Nor do Verizon's claims regarding the CLEC's "hefty" profit margins find support in the record, which is devoid of any informed evidence from VNJ demonstrating CLEC's internal costs of providing service. In fact, AT&T has demonstrated that Verizon's rate plan comparisons are unrealistic from both a revenue and cost perspective.[128] Without further compelling evidence rebutting AT&T's submission, the Board declines to reconsider its previous findings.

COST OF CAPITAL

Positions of the Parties

In its Motion for Reconsideration, Verizon argues that the Board overemphasized conventional rate case concepts in its analysis of the cost of capital component of the UNE rate.[129] Verizon contends that by doing so the Board ignored the overriding presumption that UNE rates be set in light of the risks faced by a company which is actually subject to full competition from other facilities-based carriers.[130] Verizon further contends that the Board ignored the highly relevant guidance of the Pennsylvania Commission and the FCC Wireline Bureau in the Virginia Arbitration Order, which made

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[126] *Id.* at 53-55.

[127] *Id.* at 48-53.

[128] *Id.* at 49-51.

[129] VNJ Motion at 5.

[130] *Id.*

cost of equity determinations in UNE proceedings higher than that made by this Board.[131]

Verizon also contends that the Board committed a critical error by not considering AT&T's internal cost of capital, or "hurdle rate," in determining an appropriate cost of capital for VNJ, and by assigning VNJ a cost of capital well below that rate.[132] Verizon argues that the Board's failure to benchmark its determination to AT&T's hurdle rate was inconsistent with the FCC's clarification in the TRO that the cost of capital must reflect the competitive and technological factors associated with a market in which full competition exists among facilities-based carriers.[133] Verizon goes on to argue that the Board's rejection of its proposed proxy group of diverse industrial companies is particularly arbitrary since, in VNJ's view, AT&T's hurdle rate is the most relevant real-world cost of capital value available.[134]

Verizon further claims that the 12% cost of equity set by the Board in its 2004 UNE Order was set arbitrarily in a manner that merely balanced the competing costs of equity proposed by Verizon and AT&T.[135] VNJ contends that there exists no evidence in the record equating the risk factors encountered by electric distribution and water companies and those encountered by a provider of UNEs in a competitive market.[136] VNJ disputes that the Board possesses prior regulatory experience regarding determination of a fair return on equity in regulated utility cases that can be applied to UNE rate determinations, since most of these were the result of stipulated settlements.[137] Verizon cites prior Board Orders referenced in the 2004 UNE Order that, in VNJ's opinion, indicate a lack of actual analysis and expertise regarding cost-of-capital issues demonstrated by the Board therein.[138]

Verizon further argues that the Board's rejection of its proposed UNE risk premium is based on misunderstandings of the basis of the proposed adjustment, of Verizon's position and of the FCC's TRO.[139] Specifically, VNJ argues that the Board ignored the evidence submitted by VNJ allegedly demonstrating that VNJ faces numerous risks which are not captured in the standard models presented by the parties for estimating the cost of equity.[140] VNJ contends that when assessing the risks to Verizon in providing

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[131] *Id.* at 6.

[132] *Id.* at 7-9.

[133] *Id.* at 8.

[134] *Id.* at 8-9

[135] *Id.* at 10.

[136] *Id.* at 11.

[137] *Id.* at 11-14.

[138] *Id.* at 11, fn. 28.

[139] *Id.* at 15.

[140] *Id.*

UNEs on a going forward basis, the Board erroneously ignored the FCC's requirement that state commissions assume the existence a forward-looking, ubiquitous network that uses the most efficient technology available in a competitive market, and compensate the ILEC accordingly.[141] VNJ also contends that the Board never considered whether such risks were actually captured in the cost models presented by the parties. Verizon presents new evidence in the form of excerpts from a paper recently presented to the FCC on behalf of Verizon by economist Robert S. Pindyck, not previously part of the record in this case, in support of its position regarding the deficiencies of current cost models in the record.[142]

Finally, Verizon argues that the Board was amiss in not relying on certain state decisions and over-relying on others.[143] VNJ contends that the state commission decisions referenced by the Board, those from New Hampshire and Maryland, did not rely on TELRIC principles and should be disregarded for that reason. Verizon opined that these decisions would soon be reversed.[144]

In reply to AT&T's opposition to VNJ's motion, Verizon alleges that AT&T merely reargues its position regarding the relative risks of telecommunication holding companies that comprise AT&T's proxy group.[145] Verizon also alleges that AT&T's discounting of the relevance of its own hurdle rate in calculating cost of capital is baseless and not supported by the record, since AT&T faces actual competitive risks.[146] VNJ rejects AT&T's assertion that the hurdle rate is artificially inflated to compensate for overly optimistic profit predictions, stating that AT&T never suggested such an argument in discovery.[147] VNJ also alleges that AT&T has a strong economic incentive to accurately estimate its own cost of capital, and that reliance on said rate in setting UNEs would not change this incentive.[148] VNJ also argues that reliance on AT&T's hurdle rate would be consistent with AT&T's insistence on the use of telecommunications holding companies as risk proxies. [149]

VNJ further rejects AT&T's argument that the Board's application of the same methodologies used in the Pennsylvania state commission order, cited in the 2004 UNE Order, as well as the *Virginia Arbitration Order*, to current data would produce a weighted average cost of capital.[150] VNJ claims that AT&T's assertion that cost of

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[141] *Id.* at 15-16.

[142] *Id.* at 18-19.

[143] *Id.* at 19.

[144] *Id.* at 20-23.

[145] VNJ Reply at 6-8.

[146] *Id.* at 9.

[147] *Id.* at 10-11.

[148] *Id.* at 11.

[149] *Id.* at 11-12.

[150] *Id.* at 14-16.

capital would be reduced is based on short-term interest rate changes and amounts to nothing more than baseless speculation that such methodologies would be employed in the future.[151]

VNJ also reiterates its argument concerning its proposed risk premium and argues that AT&T has simply restated its own argument in opposition thereto.[152] VNJ further rejects AT&T's opposition to its arguments concerning whether cost of equity models incorporate and reflect the relevant risk factors faced by a hypothetical UNE provider.[153] VNJ also asserts that AT&T selectively quoted VNJ's own expert, Dr. Robert Pindyck, in a misleading way.[154]

With respect to cost of capital, AT&T argues in its petition and in reply to VNJ's opposition brief that the Board should have adopted a weighted average cost of capital of 8.23%.[155] AT&T contends that the Board improperly rejected its proxy group of five publicly traded telecommunications companies, which accurately estimates the risks of supplying UNEs in a competitive environment.[156] According to AT&T, the record showed that investors impute the same risks to the companies in its proposed proxy groups as those imputed to VNJ in a forward looking environment, and that VNJ itself has warned investors of these risks.[157] AT&T claims that the perception of risk is the relevant factor in UNE rate determination, rather than the actual risk faced by Verizon.[158] AT&T opines that Verizon has provided no basis for the Board's assumption that a competitive UNE business would be perceived as materially riskier than Verizon's non-UNE lines of business, since the risks of competition impact on both areas in a way that is widely disseminated and easily recognized by investors.[159]

AT&T suggests that the Board's use of comparisons with other industries is procedurally improper, since the parties did not receive advance notice or opportunity to respond to same.[160] However, AT&T also responds substantively to these comparisons by arguing that the decisions cited by the Board are inapt or supportive of the relief sought by AT&T.[161]

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[151] *Id.* at 14-15.

[152] *Id.* at 16-19.

[153] *Id.* at 17.

[154] *Id.* at 18-19.

[155] AT&T Reply at 15.

[156] *Id.* at 16-17.

[157] *Id.*

[158] *Id.* at 16.

[159] *Id.* at 16-17.

[160] AT&T Motion at 11.

[161] *Id.* at 11-12.

AT&T further asserts that the Board improperly and arbitrarily "split the difference" between the AT&T and VNJ proposals to reach its 12% cost of equity.[162] As an example of this purported arbitrariness, AT&T cites the Board's reference to VNJ's S&P industrial proxy group which, according to AT&T, the Board should have dismissed outright as completely unreliable.[163] Moreover, AT&T rejects the Board's limited reliance on Verizon's one-stage DCF model specification for estimating earnings growth assumptions, which it claims have been widely rejected by the Board and other jurisdictions in the past.[164]

AT&T also argues that the Board erroneously adopted Verizon's proposed 6.26% cost of debt, a value based on current yield-to-maturity of Moody's A-rated industrial bonds.[165] AT&T claims that this choice in unsupported by the record and inconsistent with other Board findings.[166] AT&T argues that the Board's acceptance of this figure implies its reliance on a diversified industrial proxy group that is inconsistent with its rejection of a similar group in the Board's cost of equity calculation.[167] AT&T claims that the Board's conclusion that the lower debt estimates offered by AT&T do not fully capture the costs that a stand-alone UNE provider would face ignores the fact that investors impute the same risks to the Verizon parent entity that they would to the UNE company, whether in the context of debt or equity costs.[168] According to AT&T, the diversification of VNJ's parent company into wireless, Internet and foreign services cannot make the company less risky than the wholesale provider of UNEs.[169] Therefore, the economies of scale that arise from integrating related business operations should have been considered by the Board when determining the TELRIC cost of debt.[170]

In opposition to VNJ's motion, AT&T further reiterates its arguments, made in its motion for reconsideration, that VNJ's request for a higher cost of capital is without merit. In short, AT&T rejects Verizon's diverse proxy group and maintains its position that the risk associated with publicly traded RBOCs is greater than the risk associated with a hypothetical stand-alone UNE provider.[171] Thus, the cost of capital for the AT&T proposed proxy group is the same (or higher) than the cost of capital appropriate for VNJ UNEs.[172] AT&T also reiterates its arguments concerning its "hurdle rate" which it claims is not comparable to the appropriate rate for a stand alone UNE business. AT&T argues

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[162] *Id.* at 12-14.

[163] *Id.* at 13.

[164] *Id.* at 13-14.

[165] *Id.* at 14-16.

[166] *Id.*

[167] *Id.* at 15.

[168] *Id.*

[169] *Id.* at 16.

[170] *Id.* at 16.

[171] AT&T Opposition at 18-25.

[172] *Id.*

that such a rate is often set at an overly high level to compensate for the possibility of overly optimistic profit projections.[173] AT&T also repeats its arguments in opposition to the imposition of Verizon's so-called "risk premium."[174] Finally, AT&T endorses the Board's limited references to other state commission decisions in support of its findings.[175]

In reply to VNJ's and the RPA's opposition to AT&T's petition for reconsideration, AT&T argues that its petition properly invokes the Board's jurisdiction under N.J.A.C. 14:1-8.6.[176] AT&T also disagrees with the RPA that the legal doctrine of the law of the case applies in this proceeding, since, according to AT&T, the literal interpretation of this doctrine advocated by the RPA would eliminate the possibility any petition brought under N.J.A.C. 14:1-8.6.[177] AT&T argues that, to the extent this discretionary, judge-made doctrine applies to administrative decision making, the recognized exception for clear errors in the earlier decision applies here.[178]

In further reply to the RPA, AT&T rejects the assertion that the standard of review applied by the FCC in Section 271 cases is inapposite here. According to AT&T, the FCC utilized a highly deferential standard of review regarding the TELRIC compliance of UNE rates in its Section 271 proceedings, due to the numerous checklist items requiring review, as well as the short time-frame allowed under the 1996 Act. Thus, according to AT&T, the RPA incorrectly asserted that a range of reasonable rates were permissible under TELRIC.[179]

In its reply brief, AT&T reiterates its argument that the Board should reduce the weighted cost of capital from 9.88 percent to 8.23 percent. AT&T alleges that VNJ and the RPA offer no reason to believe that investors perceive the telephone holding companies in its proposed proxy group as less risky than the business of supplying UNEs in a competitive market.[180] AT&T affirms its assertion that the record amply demonstrates that investors attribute the risks of a competitive market to the telecommunications companies in its proxy group.[181] AT&T further restates its arguments concerning the Board's purported "50/50 split" of proposed cost of capital values and the Board's cost of debt determination.[182]

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[173] *Id.* at 27.

[174] *Id.* at 31-36.

[175] *Id.* at 36-37.

[176] AT&T Reply at 6-7.

[177] *Id.* at 8-10.

[178] *Id.*

[179] *Id.* at 11-15.

[180] *Id.* at 15-21.

[181] *Id.*

[182] *Id.* at 21-24.

In support of AT&T's Motion for Reconsideration, MCI argues that the cost of capital set by the Board was too high because the Board improperly applied rate case principles and adopted a "split the baby" approach to rate setting.[183] According to MCI, there is no reason to believe that investors do not perceive and understand the risks faced by Verizon in providing UNEs.[184] It therefore contends that the costs of equity proposed by AT&T, MCI and the RPA all fall with the "zone of reasonableness." The 12% adopted by the Board, on the other hand, was excessive in MCI's opinion.[185]

MCI also asserts that the Verizon's argument regarding AT&T's hurdle rate is simply a restatement of the same argument made in Verizon's Initial Brief. MCI argues that there is nothing in the record indicating that VNJ and AT&T face comparable costs of capital at the present time, and that strong evidence to the contrary was presented.[186] MCI also rejects the risk premium argument asserted by Verizon on reconsideration, seeing it as a repeat of the argument already considered and rejected by the Board.[187]

In opposition to the motions of both Verizon and AT&T, the RPA argues as a threshold matter that under the doctrine of the "law of the case," the Board may decline to consider VNJ's and AT&T's motions for reconsideration.[188] The RPA further argues that both parties have failed to show that the Board misapplied the TELRIC standard in establishing the cost of capital in the UNE Remand proceeding.[189] The RPA rejects VNJ's assertion that the Board was improperly influenced by rate case concepts. Rather, the RPA notes that the Board engaged in such a discussion merely to focus on the difficulty in finding an appropriate proxy group for determining an adequate cost of equity. The RPA argues that the Board's cost of equity determination was not based on improper comparisons with regulated utilities but on its analysis of the record.[190] According to the RPA,. the Board fully employed the TELRIC standard in making its cost of capital determination. It noted that there exists a range of cost figures which may fall within the TELRIC range, not simply one correct value.[191] The RPA argues that, accordingly, the Board properly exercised its lawful discretion to set a 12% cost of equity, which is above the 10% set by the Board in 1997 and accepted by Verizon as TELRIC compliant.[192]

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[183] MCI Opposition at 2.

[184] *Id.* at 4.

[185] *Id.*

[186] *Id.* at 2.

[187] *Id.*

[188] RPA Opposition at 5.

[189] *Id.* at 6-8.

[190] *Id.* at 11-12.

[191] *Id.* at 7.

[192] *Id.*

The RPA also discounts Verizon's reliance on AT&T's internal hurdle rate, arguing that Verizon offered no evidence suggesting that this rate was TELRIC compliant.[193] The RPA further rejects Verizon's arguments concerning the Board's rejection of its risk premium as simply repetitious of prior arguments made at hearing. The RPA asserts that VNJ's reference in its reconsideration brief to the *ex parte* filing before the FCC of Robert S. Pindyck was improper in that it represented cumulative evidence submitted to the Board after the close of the record that should have been introduced, if at all, prior to the Board's decision on April 2, 2004.[194]

Finally, the RPA rejects both AT&T's and VNJ's arguments that the Board's cost of capital determinations were arbitrary and capricious. According to the RPA, the Board rationally weighed the competing proposals and compared them to determinations made by five other state commissions. The RPA further argues that the Board then made a reasoned determination based on its expertise and the record in the case, clearly explaining why it concluded that an increase in cost of equity to 12% was warranted to compensate Verizon for the risks associated with the provision of UNEs going forward. The RPA opines that the Board has offered valid reasons for its choices and is entitled to deference with respect thereto.[195]

Verizon also submitted written opposition to AT&T's Motion for Reconsideration. Verizon asserts therein that the Board's rejection of AT&T's cost of equity and cost of debt positions is not based on any material misapprehension of law of fact, but rather amounts to no more than a rehash of the same arguments already made by AT&T in its testimony and briefs.[196] While VNJ agrees with AT&T that the Board's alleged "split-the-difference" approach was inappropriate, VNJ disagrees that the Board's alleged errors resulted in an unduly high cost of capital. Rather, VNJ reiterates its position that the Board's cost of capital determination is too low, according to TELRIC principles.[197] In addition to reiterating its arguments regarding the appropriate proxy group for cost of capital calculations, VNJ rejects AT&T's position that debt cost should be determined assuming that the efficient supplier of UNEs would be part of a diversified or vertically integrated entity, rather than a stand-alone company. Verizon claims that this position to be inconsistent with FCC pronouncements on this issue.[198]

Board Discussion

The Board rejects the arguments of AT&T and Verizon with regard to cost of capital. Specifically, the Board disagrees that its findings regarding the cost of equity and debt are not based on sound analysis firmly grounded in the TELRIC methodology and on evidence in the record.

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[193] *Id.* at 8, fn. 17.

[194] *Id.* at 8, fn. 18.

[195] *Id.* at 11-12.

[196] VNJ Reply at 5.

[197] *Id.* at 5-11.

[198] *Id.* at 12-16.

Rate Case Proceedings

As a preliminary matter, it is clear that Verizon, AT&T and MCI have misconstrued the Board's references to rate case proceedings for traditionally regulated services. Even the most perfunctory reading of the 2004 UNE Order reveals that the Board's references to conventional monopoly utilities do not evidence any intention to substitute rate-base/rate-of-return regulation for the analytical assumptions and parameters underlying TELRIC. Rather, it is clear that they were merely intended to illustrate the difficulty the Board faced in determining a TELRIC-compliant cost of equity for Verizon UNEs in the absence of a comparable real-world proxy group of companies whose sole line of business is the sale of UNEs.[199] Faced with such difficulties, the Board cited its general regulatory experience in the area of traditional utilities in support of its reasonable exercise of discretion in determining an appropriate cost of equity based on the competing proxy groups put forward by the parties.[200]

From the Board's limited references to its ratemaking expertise, Verizon somehow extracts the notion that the Board has "ignored" the FCC's requirement that the cost of capital for UNE rate-setting must reflect the risks of a market in which Verizon faces facilities-based competition.[201] However, the Board repeatedly acknowledged that the cost of equity determinations shaped by the unique risks faced by electricity and gas utilities were not the same as those faced by a company selling UNEs in a competitive environment.[202] Moreover, the Board's cost of capital analysis was shaped throughout by the assumptions and analytical parameters of TELRIC, as clarified in the TRO.

The Board reasonably relied on its regulatory experience and expertise, derived from cost of capital determinations of all types, including those undertaken in other regulated and restructured industries, to enable it to establish a fair cost of capital for Verizon's UNE business according to TELRIC principles. VNJ, by focusing on the few rate cases cited by the Board as recent examples of Board action in this area, ignores the basic point that the Board has acquired extensive experience in setting the cost of capital over many years. This experience, though not necessarily acquired in the context of a TELRIC-based UNE proceeding, is still highly relevant to the basic task at hand: determining what cost of equity adequately compensates VNJ for the risk inherent in its provision of UNEs. Indeed, no party has offered any evidence demonstrating that the forward-looking assumptions underlying TELRIC conceptually alter the discrete cost of equity analysis that the Board must undertake to set UNE rates. Rather, the Board must still determine an appropriate risk assessment model and apply it to an appropriate

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[199] 2004 UNE Order at 17-19.

[200] Verizon and AT&T argue that they were deprived procedural due process by the Board's failure to provide prior notice of its references to regulated rate proceedings as part of its analysis. The Board notes, however, without agreeing that any party was deprived due process, that VNJ and AT&T have now been afforded ample opportunity to respond substantively to the Board's actions and have taken full advantage of this opportunity, filing motions for reconsiderations, briefs in opposition thereto, and reply briefs. The Board has also considered and addressed their arguments herein. We therefore reject the suggestion that the Board has violated the procedural rights of any party to this proceeding.

[201] VNJ Motion at 5.

[202] 2004 UNE Order at 19.

proxy group of companies to assess forward-looking risk. Nor does the TRO, which mandates the assumption that Verizon provision of UNEs in a fully competitive environment, change this basic analysis, in which the Board is well versed.

Moreover, that fact that some of the rate case determinations cited by the Board were the result of stipulated settlements rather than formal adjudications does not mean, as Verizon suggests, that the Board did not review the discrete cost of capital element therein. Nor would the Board have approved the overall stipulated revenue requirement if the cost of capital element was not reviewed and determined to be reasonable. Thus, the Board's overall expertise, derived not merely from five recent rate cases but through years of adjudication of such cases (both settled by stipulation and litigated to completion) in which a cost of capital determination was an integral part, is relevant to determining what cost of capital is appropriate in a UNE proceeding applying TELRIC principles.

Proxy Groups

With respect to the cost of equity issue, there exists ample evidence in the record to support our conclusion that neither Verizon's nor AT&T's proxy groups of comparable companies adequately represents the risk profile of a business entity whose sole product is UNEs on a going forward basis. As we stated in the 2004 UNE Order, the broad selection of companies represented in Verizon's S&P Industrial proxy group, including automobile manufacturers, oil companies, producers of food and food ingredients, publishing, entertainment and pharmaceutical firms, represents a vastly diverse risk profile.[203] We agree with AT&T that any attempt to link the risk profiles of these companies to that of a stand-alone UNE company based on the existence of competition is simplistic. Given the range of perceived risk represented in such a group, and despite VNJ's assertion that the group is nonetheless an adequate proxy for a stand-alone UNE provider because of the "competitive" nature of the companies, the Board rightfully rejected this group as not reflective of the risk faced by a UNE provider going forward.

At the same time, the AT&T group of risk proxies, consisting of five publicly traded telecommunication holding companies, is of a smaller size than would typically be deemed adequate for the estimation of risk related to a cost of equity determination.[204] These companies may be seen as less risky than a stand-alone UNE provider because of their ability to diversify away many of the risks facing a company whose sole business is the provision of wholesale UNEs in a competitive environment.[205] We reject as unsupported AT&T's argument that such an ability to diversify into various retail services creates more, rather than less risk for the diversifying company. While full-service, vertically integrated telecommunication companies may indeed face high risk in a competitive environment, we find that there is no evidence in the record suggesting that such risk would be higher than that of a UNE provider. In fact, AT&T provided no

[203] AT&T Motion at 20; AT&T IB at 39.

[204] VNJ Motion at 42.

[205] *Id.*

compelling evidence to rebut Verizon's assertion that the ability to diversify reduces, rather than increases, business risk.[206]

In the 2004 UNE Order the Board also rejected, and explicitly does so again here, AT&T's argument that the Board may assume that the hypothetical stand-alone UNE provider is an integrated, diversified telecommunications company for the purposes of UNE rate setting. The Board finds no evidence in the record or support from the FCC for this assumption. Nor, contrary to AT&T's assertion, does the FCC's Local Competition Order support such a conclusion.[207]

The Board analyzed the conflicting evidence and determined that neither proxy group adequately reflected the risk profile of a hypothetical UNE provider. It rejected VNJ's group because of its obvious lack of comparability to the UNE firm and lack of common risk factors among the 200-odd firms in the group. By contrast, however, the firms in the AT&T group, while fewer in number than is ideal for risk comparison purposes, at least possessed some similarities with a UNE firm, including for some the actual provision of UNEs. Based on its expertise in setting the cost of capital in other rate cases and the requirements of the TELRIC methodology, the Board determined that unqualified acceptance of the AT&T proxy group would result in an understatement of the risk faced by Verizon on a long-run basis. Thus, the Board adjusted its cost of equity determination by the amount it considered necessary to adequately compensate Verizon. This adjustment also took into consideration recent changes in interest rates and inflation.[208] The fact that it was in some way compared to prior electric and gas cost of equity decisions does not mean, as Verizon and AT&T suggest, that the Board did not consider differences between those analyses and the UNE determination. Rather, the Board expressly acknowledged that "the overall risk of providing UNE services is greater than the risk associated with traditional utilities."[209]

<u>Risk Premium</u>

The Board also rejects Verizon's renewed attempt to add a so-called "risk premium" to its cost of equity calculation. Contrary to Verizon's assertion, the Board did not misunderstand the FCC's directives regarding UNE pricing assumptions in this context. Nor did it ignore the assertion that numerous risks facing ILEC UNE providers such as VNJ are allegedly not captured in the standard cost models presented by the parties.

In rejecting the risk premium, the Board disagreed with Verizon's unsupported assertion that it was contractually required to make large sunk investments for the benefit of CLECs, which, according to VNJ, supported its claimed need for a higher cost of equity.[210] The Board correctly found that the FCC places no such obligations on the ILECs. Nor does the record support Verizon's assertion.[211] In fact, evidence suggests

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[206] See VNJ Opposition at 5-6.

[207] VNJ Opposition at 15, citing *Local Competition Order* at ¶11

[208] 2004 UNE Order at 19-20.

[209] *Id.* at 20.

[210] VNJ IB at 17.

that VNJ provides UNEs from spare network capacity.[212] Even assuming that such future investments are made, Verizon has not indicated what portion, if any, will be in services that are subject to the FCC's unbundling requirements.

Instead, Verizon now argues that the Board missed the point it attempted to make, namely that TELRIC pricing requires the assumption that facilities-based competition exists.[213] However, the Board quite clearly understands that, while it must assume that facilities-based competition exists when determining VNJ's cost of capital going forward, Verizon must still demonstrate that such a competitive environment would in fact demand the level of investment for which Verizon claims it must be compensated, whether it intends to actually deploy such technology or not. There is no evidence in the record indicating that VNJ's "large sunk investments" requiring an extraordinary increase in cost of equity would actually be required in the competitive environment that the Board is required to presume. Given this lack of evidence, the Board reasonably rejected VNJ's request.

The Board has also considered VNJ's reiterated assertion that the cost models presented by the parties do not capture the (as VNJ sees it) extraordinary business risks associated with the provision of UNEs going forward. As stated in the 2004 UNE Order, VNJ only quantified one of the so-called added risk factors that allegedly could not be captured in any cost model: the risk of unilateral cancellation of CLEC contracts by CLECs, to the detriment of VNJ. However, as the Board pointed out previously, the short-term unrestrictive nature of ILEC/CLEC contracts could just as easily benefit VNJ, since TELRIC-based rates could rise as well as fall in a forward-looking environment. Thus, the "risk" that the cost models allegedly fail to capture is itself highly speculative in nature, and of no import to the Board's determination of cost of capital.

Moreover, the record does not contain compelling evidence suggesting that any regulatory or economic risk faced by a stand-alone UNE provider in a competitive environment would not be fully known and understood by investors, and therefore captured in a DCF risk/price analysis used in the models presented by all parties. Given the high level of dissemination of information among investors regarding the regulatory risks to ILECs (well documented in the record and largely unrebutted by Verizon)[214] the Board properly found that the lease-cancellation risk was part of the overall expected business risk faced by all ILECs, and known to investors, such that there was no reason to believe that it was not accounted for by standard cost models incorporating risk assessment components. Verizon provides no new argument requiring the Board to reconsider its conclusions.[215]

The Board further agrees with the RPA that Verizon's *ex parte* filing before the FCC by Dr. Pindyck, submitted in support of its Motion for Reconsideration, should have been

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211 AT&T IB at 63.

212 *Id.*

213 VNJ Motion at 15.

214 AT&T IB at 38, 56

215 According to the evidentiary record, it is Verizon, not the CLECs, that requires short-term, one-month UNE contracts, leading to the logical conclusion that Verizon itself views such contracts as reducing rather than increasing its business risk. (AT&T IB at 64)

submitted as part of the record in the prior proceeding.[216] Even considering the substance of this filing, the Board finds that it merely reiterates VNJ's core argument, already rejected by the Board, that the weighted cost of capital should be augmented with a risk premium to compensate for uncaptured risk factors.[217]

State Decisions

Verizon's rejection of two state decisions cited by the Board in connection with its cost of capital determination, those of New Hampshire and Maryland, is not grounds for reconsideration. As a threshold matter, Verizon's objection is largely irrelevant because the Board did not *rely* on any other state decision in determining the appropriate cost of capital for Verizon's UNEs. Rather, citation to other jurisdictions was merely meant to illustrate the wide range of capital cost values derivable under TELRIC.[218] As the Board stated in its 2004 UNE Order, the decisions in those states are of interest to the Board merely for the purpose of trying to better understand the conflicting arguments presented by the parties as well as the divergent decisions; however, the totality of the record developed in this proceeding and the Board's expertise in examining cost of capital issues govern its decision. Verizon has erroneously interpreted the Board's reference to the decisions of two states that produced values similar to New Jersey's as an arbitrary and capricious rejection of the findings of other states. However, since no reference to any state decision served as an integral part of the Board's analysis, Verizon's emphasis on the Board's treatment of other state's decisions is misplaced.

It follows that, contrary to the arguments of VNJ, AT&T and MCI, the Board did not merely "split the baby" in its determination of an appropriate cost of capital for Verizon UNEs. Rather, as the RPA has pointed out, the Board carefully considered and appraised the evidence put forward by the parties.[219] For the reasons stated above and in the 2004 UNE Order, the Board determined that a 12% cost of equity would adequately compensate VNJ for the risks it would face in a competitive environment. This finding took into account the difference between the historically low interest rates and levels of inflation in the current economic environment and the more normal levels in effect in the past.[220]

Moreover, the parties' fixation on the word "balance," which is claimed to indicate arbitrary action by the Board, is not warranted given the context in which the word was used in the Order. It is clear from that context that the Board was not referring to a literal balancing, or "splitting the difference" between the cost figures proposed by AT&T and VNJ. Rather, the Board used the term merely to denote the inadequacies of both figures as polarized opposites, and the Board's attempt to discern the appropriate figure in light of these inadequacies.[221] Thus, given the plethora of analysis provided in the 2004 UNE

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[216] RPA Opposition at 8, fn. 18.

[217] VNJ Motion at 18-19.

[218] 2004 UNE Order at 15.

[219] RPA Opposition at 11-12.

[220] 2004 UNE Order at 20.

[221] *Id.*

Order, the Board rejects the parties' arguments that its cost-of-capital determination was a mere compromise between competing proposals.

Cost of Debt

The Board also reviewed the parties' proposed costs of debt within the TELRIC framework, and determined that Verizon's 6.26% to be the most predictive of the actual cost of debt faced by a UNE provider on a going forward basis. In response, AT&T reiterates its argument that a lower cost of debt is appropriate. AT&T argues that the Board has improperly used bond yields from the Moody survey as the basis for its cost of debt determination, when it used a narrower, less diverse proxy group to determine the TELRIC-compliant cost of equity for VNJ's provision of UNEs. However, AT&T misconstrues the Board's analysis. A hypothetical UNE firm has no market cost of debt from which to gauge the accuracy of the Board's determination. However, it is reasonable to assume that debt generating capacity of the UNE firm would more closely resemble that of an industrial company than that of a vertically integrated telecommunications provider. Thus, a greater cost of debt than that proposed by AT&T is justified.

Moreover, the Board made clear in the 2004 UNE Order that it does not accept AT&T's debt calculations based on Verizon's current diversified business strength as a valid way to capture the costs of a stand-alone UNE provider in a facilities-based competitive environment.[222] The FCC's TRO makes clear that such a provider would generally face heightened risks in a going-forward environment, which the Board is satisfied are not adequately accounted for by AT&T's calculations.[223] Nor does the Board accept AT&T's reliance on debt issuances that have expired or will shortly expire to calculate cost of debt. AT&T did not effectively rebut VNJ's assertion that short-term debt used to finance short-term assets is not appropriate for determining the cost of long-term debt used to finance long-term assets, such as telephone network assets. The Board also found that AT&T's conclusions regarding cost of debt are based on an assumption that, as stated above, is not clearly endorsed in the TRO or supported in the record, that the hypothetical UNE supplier may be viewed as a diversified or vertically integrated telecommunications entity for cost of debt purposes. The Board declines to embrace such a position in the absence of evidentiary support in the record.

Hurdle Rate

The Board similarly rejects VNJ's lengthy argument regarding the relevance and importance of AT&T's internal "hurdle rate" in determining the appropriate cost of capital in this proceeding. Verizon essentially reiterates is previous assertions and presents no new evidence in support thereof or to rebut AT&T's claim that its internal hurdle rate is deliberately set at an abnormally high level to compensate for overly optimistic profit projections. Nor does Verizon adequately explain why the Board must accept the particular hurdle rate it presents as appropriate for UNE facilities when it is clear from the

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[222] *Id.*

[223] TRO at ¶681.

record that AT&T (or any firm) varies its hurdle rate according to the specific projects/investments at issue.[224] No support exists for equating, *per se*, this single AT&T hurdle rate with the expected returns demanded for a VNJ stand-alone UNE business.

Most importantly, as stated by the RPA, whatever the relevance of the AT&T hurdle rate to the Board's determination (and AT&T argues there is little or none) Verizon has not even attempted to demonstrate to the Board that the rate itself is TELRIC-compliant.[225] Without this threshold showing, the Board declined to give the rate any weight in its cost of capital determination, and continues to do so now in the absence of new evidence presented by Verizon.

SCOPE OF REVIEW

The Board further rejects AT&T's renewed argument concerning the Board's review of depreciation lives and cost of capital without further analysis of other inputs to VNJ's UNE prices at this time. In its opposition to AT&T's Motion, Verizon argues that the Board properly exercised agency discretion to reopen the UNE proceeding to adjust the cost of capital and depreciation inputs in light of the FCC's TRO directives. Verizon also argues that AT&T has misinterpreted the Seventh Circuit's decision in AT&T Communications, Inc. Illinois Bell Tel. Co., 349 F.3d 402, 408 (7th Cir. 2003), and that nothing in that decision precludes the limited action taken by the Board. The Board agrees with Verizon and notes that it has previously addressed this very issue and determined that its decision to limit its review to two UNE rate elements was both lawful and procedurally sound.[226] In its Motion for Reconsideration AT&T merely reiterates its former argument in opposition to the Board's decision. Said argument having already been carefully considered and rejected by the Board and in the absence of newly presented evidence, the Board declines to reconsider its decision.

LOOP PRICING

Positions of the Parties

In its Motion for Reconsideration, Verizon requests that the Board reopen its UNE proceeding with respect to loop pricing. VNJ maintains that the recent D.C. Circuit decision in *USTA II* invalidates the Board's previous decision related to the level of Integrated Digital Loop Carrier ("IDLC") utilized in the network. According to VNJ, the D.C. Circuit's decision had the effect of substantially revising the business of providing UNEs to CLECs from one that relies primarily on the UNE Platform of elements ("UNE-P") to one that utilized UNE loops ("UNE-L") and transport.[227] As Verizon sees it, the

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[224] AT&T Opposition at 27-28.

[225] RPA Opposition at 8, fn. 17.

[226] 1/26/04 Order at 12-14.

[227] VNJ Motion at 42-43.

USTA II decision effectively eliminates unbundled switching as a network element required to be provided to CLECs at TELRIC rates.[228]

VNJ also asserts that the Board's March 6, 2002 UNE Order, and the rates set pursuant thereto, were premised on the Board's assumption that a forward-looking network would utilize a high level of IDLC to provide UNE-P to CLECs. However, the Company argues that IDLC is incapable of providing the unbundled loops which will, in VNJ's opinion, constitute the sole means by which UNEs are provided to CLECs going forward. Therefore, VNJ argues that the Board must reopen the UNE proceeding to reconsider UNE-L rates.[229]

In reply to the RPA's opposition brief, VNJ rejects the notion that it is precluded from raising the IDLC issue by the Stipulation and Agreement it entered into with the Board in settlement of the civil matter entitled Verizon New Jersey v. New Jersey Board of Public Utilities et al., since this Agreement does not preclude other issues being revisited by the Board.[230] Moreover, VNJ alleges that the RPA's claim that the doctrines of waiver and judicial estoppel prohibit the Board from re-evaluating its IDLC assumption. VNJ argues that it never represented to the FCC that the Board-established UNE rates were TERLIC compliant.[231] VNJ also claims that it is entirely appropriate for it to request that the Board modify its prior decision in light of a specific change in circumstances that supports the review, namely, the *USTA II* decision.[232]

AT&T opposes a reopening of the UNE-L rate issue by reiterating its argument that the Board may not address discrete rate components in this proceeding, but must leave existing rates in place or address all UNEs in setting new rates.[233] AT&T also disputes VNJ's interpretation of the *USTA II* decision. AT&T asserts that the D.C. Circuit set aside the FCC's nationwide finding that CLECs would be impaired without unbundled access to mass market ILEC switching because the FCC had unlawfully delegated to state commissions its authority to make a "granular" impairment determination and the FCC's justification for its nationwide impairment finding was insufficient. AT&T claims that the Court did not eliminate UNE-P, as VNJ suggests, but in fact remanded the unbundled switching issue to the FCC for further rulemaking.[234]

MCI briefly addressed the IDLC issue by asserting that VNJ's request for a reopening of the IDLC issue should only be granted as part of a complete reopening if the UNE proceeding record.[235]

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[228] *Id.*

[229] *Id.*

[230] VNJ Reply at 33-35.

[231] *Id.* at 34.

[232] *Id.*

[233] AT&T Opposition at 42-46.

[234] *Id.* at 44

[235] MCI Opposition at 1.

The RPA opposes Verizon's request to reopen the record with respect to the IDLC issue. The RPA argues that the Stipulation and Agreement between VNJ and the Board arising out of the law suit entitled Verizon New Jersey, Inc. v. Board of Public Utilities, et al. embodied an agreement between the parties that only two issues, cost of capital and depreciation, would be re-examined by the Board. According the RPA, VNJ is precluded by this Agreement from requesting that the Board revisit any other aspect of UNE rates.[236]

The RPA also argues that Verizon is precluded by the doctrines of waiver and judicial estoppel from claiming that the Board's resolution of the IDLC issue in its March 6, 2002 final UNE Order resulted in non-TELRIC rates.[237] The RPA argues that Verizon's representations to the FCC that the UNE rates set by the Board in 2002 were TERIC-compliant, which resulted in VNJ receiving FCC approval to offer long-distance service in New Jersey under Section 271 of the 1996 Telecommunications Act, preclude Verizon from taking a different position now simply because its interests have changed.[238]

Board Discussion

We disagree that VNJ's request for a limited reopening of the proceeding to examine the Board's IDLC assumptions is warranted at this time. The Board rejects Verizon's far-reaching interpretation of the *USTA II* decision offered in support of its request. Nowhere in this decision does the D.C. Circuit expressly eliminate UNE-P as a viable means for providing telephone service for CLECs or require that UNE-P customers be migrated to UNE-L. Rather, as AT&T points out, the Court invalidated the FCC's mass-market switching impairment finding for procedural reasons and due to a lack of sufficient basis in the record. The Court then remanded the matter to the FCC for further rulemaking. Thus, it is at best premature to assume, as VNJ apparently does, that CLEC's are now effectively required to migrate to UNE-L. Such an assumption would require the Board to anticipate, in an entirely speculative manner, what action the FCC will take on this issue. This the Board declines to do.

It follows that Verizon has provided no grounds for reopening the Board's UNE proceeding with regard to IDLC at this time. Should new federal rules or other FCC action necessitate such a reopening in the future, the Board is prepared to revisit the issue at that time.[239]

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[236] RPA Opposition at 5-6.

[237] *Id.*

[238] *Id.*

[239] Given its interpretation of the USTA II decision and the current state of controlling federal law, the Board need not address the limitations and preclusive effect of the Board's December 19, 2003 Stipulation and Agreement arising out of its law suit with Verizon or the technical feasibility of providing unbundled two wire loops using IDLC, except to note that significant disagreement exists between Verizon and AT&T on the technical issue.

VERTICAL FEATURE SWITCHING COSTS

During the hearings held by the Board in connection with this proceeding, AT&T submitted rebuttal testimony alleging that VNJ had improperly weighted five of the vertical features in the vertical feature study resulting in an overstatement of the switch port costs by $1.25 per month.[240] AT&T argued that in the absence of actual cost data, the three features should have a zero cost value attributed to them. In response, VNJ proffered testimony asserting that the Telcordia SCIS model submitted in this proceeding produced reasonable costs estimates for the vertical features at issue.[241] Although not identified in the Order reopening the UNE matter, the Board determined that reviewing the issue of vertical feature costs would further its efforts to ensure that lawful, TELRIC compliant rates were produced. The Board therefore determined that review of this issue was proper.[242]

After careful and thorough review of both the AT&T and VNJ methodologies, the Board concluded that both approaches failed to properly capture the appropriate feature costs for the switch technologies where no actual cost data is available. The Board rejected VNJ's proxy approach as unjustifiably leading to higher switching costs. The Board similarly rejected AT&T's methodology as failing to capture actual vertical feature costs that VNJ incurred in the provision of service.[243]

In response to this dispute, Board Staff developed an alternative cost allocation that utilized the known feature costs for each switch technology. In its analysis, Staff examined the actual known cost data that was developed in the SCIS model for both originating and terminating features where complete cost data was available by switch technology for each feature being offered. Based on the data, Staff developed two separate cost allocation factors: one for Originating Features and one for Terminating features. The resulting ratios were used to allocate the known feature costs by switch technology to the switch technology or technologies where actual cost data was unavailable.[244]

The Board found that Staff's weighting methodology was more accurate than AT&T's or Verizon's, because it took into account that fact that each switch technology has its own unique cost characteristics and recognizes that there is a variation in costs among the switch types utilized by VNJ. Staff's methodology also takes into account the variation in costs between both originating and terminating features by using a specific allocation factor for each type of feature. The Board also invited the parties to submit comments on Staff's methodology.[245]

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[240] Baranowski RT at ¶9. *See also* AT&T IB at 72.

[241] Prosini ST at 4-9 to 5-7.

[242] 2004 UNE Order at 35.

[243] *Id.* at 36.

[244] *Id.* at 37.

[245] *Id.*

Positions of the Parties

On May 14, 2004 AT&T and VNJ submitted comments in response Staff's alternative switch methodology. Both AT&T and VNJ criticize the methodology. According to AT&T, Staff's approach incorrectly includes Warm Line and Home Intercom features in developing its ratios. Moreover, AT&T argues that an alternative methodology cannot bridge the gap caused by the lack of actual SCIS cost algorithms.[246] AT&T asks the Board to disallow what it describes as the undocumented costs pending a revised model with properly documented cost algorithms.

VNJ avers that Staff's approach understates the forward-looking cost that the Company could reasonably be expected to incur.[247] Therefore, according to VNJ, the Board should accept the SCIS calculations because they represent a more reasonable approach than Staff's alternative methodology. Alternatively, VNJ suggests that Staff should modify its ratio to, as VNJ sees it, more accurately estimate the relationship between the total forward looking feature costs for the three switch technologies, i.e., develop a ratio based upon total originating and terminating feature costs instead of separate ratios for originating and terminating features.[248] In support of its position, VNJ contends that because the originating and terminating feature investment is recovered in the UNE port charge, there is no rational basis for separately calculating originating and terminating feature investment relationships.[249]

In its petition for reconsideration, Verizon reiterates its main arguments concerning Staff's modifications to the SCIS Model and requests that the Board modify its Order to establish vertical feature costs based upon the methodology in the Telcordia SCIS Model. VNJ also asks the Board to reconsider its decision with respect to the Board's alternative switching methodology.[250] According to the Company, the Board's alternative methodology was presented after the close of the evidentiary record and therefore the Board should adopt the SCIS methodology as submitted by Verizon NJ.[251] In support of its position, the Company asserts that it is unaware of any state agency that has modified the SCIS methodology for calculating SCIS cost.[252] The Company believes the Board Staff's "alternative methodology" for establishing vertical feature switch costs understates the forward looking costs that Verizon NJ can reasonably expect to incur in connection with the provision for switching of UNEs.[253] VNJ also argues that Staff's

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[246] AT&T Comments at 2.

[247] VNJ Comments at 1.

[248] VNJ Comments at 2.

[249] VNJ Comments at 3.

[250] VNJ Motion at 38-41.

[251] *Id.* at 39.

[252] *Id.*

[253] *Id.*

methodology is internally inconsistent, because it ignores the circumstances where the application of the SCIS surrogate assumption results in conservative cost estimates.[254]

In reply to AT&T's opposition to its motion, VNJ reiterates its arguments concerning the appropriate estimation of vertical feature costs.[255] VNJ further argues that AT&T's approach unnecessarily excludes valuable data from the SCIS cost model regarding cost relationships between different switching technologies.[256] As a result, according to VNJ, AT&T's approach to calculating feature costs lacks predictive accuracy.[257] VNJ also submitted the certification of Eugene J Goldrick, who explained that AT&T's criticism of the Board's alternative methodology are generally invalid. While not acknowledging that Staff's methodology should be adopted, Mr. Goldrick states that the "Board's method is statistically sound because it considers all of the available cost information."[258]

AT&T and MCI also ask the Board to reject Staff's alternative switching methodology and adopt AT&T approach originally advocated in the case which produced a cost of zero for the three features.[259] Citing case law from various jurisdictions, AT&T claims in its Comments that, pursuant to basic concepts of procedural fairness, the Board should assign a zero value to any vertical feature cost for which VNJ's SCIS model provides no cost algorithm, since VNJ has failed to carry its burden of proof with respect thereto.[260]

In further argument in opposition to Staff's alternative methodology, AT&T offers the affidavit of Matthew G. Mercurio.[261] Dr. Mercurio opines that Staff's methodology is flawed in two ways. First, according to Dr. Mercurio, Staff has failed to apply its own methodology in an internally consistent manner because the overall investment ratios derived by Staff were not based on the same number of vertical features for each switch type.[262] Secondly, AT&T disputes Staff's assumption that the average vendor-to-vendor ratios of investment per line for the vertical features documented by SCIS are a good proxy for the vendor-to-vendor ratios for the three specific vertical features with missing cost documentation.[263]

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[254] *Id.* at 40.

[255] VNJ Reply at 26-30.

[256] *Id.* at 30.

[257] *Id.*

[258] Certification of Eugene J. Goldrick, In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc., Docket No. TO00060356 (June 18, 2004) ("Goldrick Cert.").

[259] AT&T Comments at 6; AT&T Opposition at 44; MCI Opposition at 3.

[260] AT&T Comments at 5.

[261] Affidavit of Dr. Matthew G. Mercurio on Behalf of AT&T Communications of NJ, L.P., In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc., Docket No. TO00060356 (July 5, 2004) ("Mercurio Affidavit")

[262] Mercurio Affidavit at 4.

[263] Mercurio Affidavit at 5.

Board Discussion

In seeking reconsideration of the Board's decision VNJ generally argued that the Board's methodology failed to produce proper forward-looking feature costs. In their May 14, 2004 comments, both AT&T and VNJ generally assailed Staff's alternative methodology. Both the AT&T and VNJ criticisms are unfounded. In the Board's 2004 UNE Order, the Board described the development of Staff's alternative methodology.[264] In developing the ratios, Staff included all known cost data, but excluded data from vertical features where data was incomplete so that the resulting ratios would be unbiased.

In approving Staff's alterative methodology, the Board acknowledged that in the absence of complete cost data, estimates based upon sound cost allocation techniques are appropriate. While the parties generally disagree with Staff's alternative methodology, VNJ, through the affidavit of Eugene J Goldrick, acknowledges that Staff's alternative methodology is, in fact, statistically sound. The Board agrees. Moreover, the Board adheres to its previous explanation as to why it favors Staff's analysis of actual known cost data and its computation of ratios used to derive cost values missing from the VNJ cost models.

All parties to this proceeding acknowledge or fail to dispute that VNJ incurs real costs in providing the vertical features at issue herein. Given this reality, the Board's failure to attribute any costs whatsoever to the provision of these services would indisputably result in UNE rates that did not accurately reflect the correct forward-looking costs incurred by VNJ for the provision thereof, in direct violation of the FCC's TELRIC standard. Yet this is precisely what AT&T and MCI ask the Board to do. While purporting to highlight alleged errors in Staff's methodology (the validity of which Verizon disputes), AT&T would have the Board rectify these alleged deficiencies by dramatically deviating from the TELRIC standard and ignoring known service costs in calculating UNE rates. The Board disagrees that it is required to violate TELRIC in this manner.[265]

We also reject AT&T's criticism that Staff did not apply its own methodology consistently.[266] AT&T rejects Staff's inclusion of costs for both the Home Intercom and Warm Line vertical services in the development of its allocation factors. According to AT&T, the aforementioned features should not have been included because the SCIS documentation only contained costs for one or two switch technologies, not all three.

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[264] 2004 UNE Order at 37.

[265] The case law cited AT&T cites in its Comments in support of its contention that the Board must disregard the feature costs at issue is inapplicable to the facts herein. In San Antonio, Texas v. United States, 631 F.2d 831, 841-44 (D.C. Cir. 1980), the Court invalidated one part of an Interstate Commerce Commission ("ICC") rulemaking because a rate additive imposed by the ICC was completely unsupported by the record and resulted in double counting of costs. See also, Celanese Chemical Co. v. United States, 632 F.2d 568, 575-76 (5th Cir. 1980). Neither case stands for the notion, asserted by AT&T, that the Board may not determine which of various methodologies for calculating vertical feature costs presented by the parties produces cost values that most nearly adhere to the TELRIC standard required by the FCC. Staff's methodology clearly meets this criterion, since neither AT&T's nor Verizon's are based on any substantive evidence in the record.

[266] Mercurio Affidavit at 4.

We reject such criticism as unfounded. As explained in the Board's 2004 UNE Order, Staff's methodology is predicated on observing all available costs to develop an allocation factor to estimate costs where such cost data is unavailable. To exclude available observations would be to introduce an unjustified bias to the results.

Similarly, we reject AT&T's criticism of Staff's methodology as being valid only if the average vendor-to-vendor ratios for the documented costs were a good proxy for the three vertical features with missing cost data. The only way to validate AT&T's assumption would be to compare the actual documented cost data for all features. However, since the cost data contained missing algorithms for three features, necessitating the need for cost estimates, this would be impossible. The Board acknowledges that any method available for the calculation of vertical feature costs for which no actual data is available depends on the substitution of an estimated proxy value for the missing data. Even if that estimate does not perfectly reflect the precise missing numeric values, the Board found, and still finds, that Staff's methodology produced the most accurate cost values in comparison to any other approach offered into the record by any party.

Although VNJ suggests that the Board should consider revising its allocation method to include both originating and terminating features to develop a single ratio as opposed to two separate ratios, we decline to do so. In arriving at this decision, we agree with Staff that the there is a discernible difference in costs for the originating and terminating features. It is therefore appropriate to consider the variations in the costs when developing the allocation factors. By doing so, we are able to more accurately estimate the costs of vertical features in the absence of actual cost data. In the Board's May 7, 2004 Decision and Order we recognized this fact when we found that Staff's weighting methodology is more accurate than AT&T's and VNJ's methodologies because it takes into account the fact that each switch technology has its own unique cost characteristics and recognizes that there is a variation in costs among the switch types utilized by VNJ.[267] To deviate from this would surely result in a less accurate portrayal of the costs.

No argument or evidence presented by the parties on motions for reconsideration represents any new or additional evidence supporting reconsideration, or changes the Board's view regarding the deficiencies in both Verizon's and AT&T's approaches to addressing this issue. Nor is the Board swayed from its determination that Staff's algorithm produces the most accurate and fair cost values available.

CONCLUSION

The Board finds that no party has shown sufficient cause for reconsidering any aspect of the Board's 2004 UNE Order. For this reason, the Board **HEREBY DENIES** Verizon's Motion for Reconsideration and Request for Limited Reopening and **DENIES** AT&T's Petition for Reconsideration. The Board further **DENIES** the Ratepayer Advocate's Motion to Strike, **DENIES** AT&T's Motion to Strike and further **ADMITS** into evidence the affidavit of Matthew G. Mercurio.

In issuing the foregoing Order the Board is aware that the FCC is currently in the process of formulating new rules for the implementation of Section 251(c)(3) of the 1996

[267] 2004 UNE Order at 37.

Act, on remand from the D.C. Circuit.[268] As an alternative to further challenges to UNE rates as set forth in this docket, any interested party that wishes to pursue a review of all inputs and assumptions used in determining UNE rates may file a petition with the Board to initiate such a review. Should any party choose to file such a petition, Staff will convene a meeting with all interested parties shortly thereafter to determine the appropriate course of action.

DATED: 9/22/04

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[268] I/M/O Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338, WC Docket No. 04-313, Order and Notice of Proposed Rulemaking, Adopted July 21, 2004.

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